

TAX-EXEMPT ORGANIZATIONS AND CHARITABLE GIVING

Senate Finance Committee Staff Tax Reform Options for Discussion

June 13, 2013

This document is the ninth in a series of papers compiling tax reform options that Finance Committee members may wish to consider as they work towards reforming our nation's tax system. This compilation is a joint product of the majority and minority staffs of the Finance Committee with input from Committee members' staffs. The options described below represent a non-exhaustive list of prominent tax reform options suggested by witnesses at the Committee's 30 hearings on tax reform to date, bipartisan commissions, tax policy experts, and members of Congress. For the sake of brevity, the list does not include options that retain current law. The options listed are not necessarily endorsed by either the Chairman or Ranking Member.

Members of the Committee have different views about how much revenue the tax system should raise and how tax burdens should be distributed. In particular, Committee members differ on the question of whether any revenues raised by tax reform should be used to lower tax rates, reduce deficits, or some combination of the two. In an effort to facilitate discussion, this document sets this question aside.

CURRENT CHALLENGES AND POTENTIAL GOALS FOR REFORM

Under current law, certain organizations that serve public interests are eligible for two main tax benefits: an exemption for their earnings from the income tax and, for a sub-set of such organizations, a deduction for donations to the organization.

Tax-exempt organizations must meet certain requirements to achieve and maintain their tax-exempt status. For example, tax-exempt organizations must be nonprofits, cannot have shareholders or owners, and generally cannot use the organization's assets to provide a benefit to a person or entity that is closely related to the organization. Most tax-exempt organizations are subject to a tax on unrelated business income for earnings not linked to their charitable mission.

The deduction for contributions is limited to donations to certain categories of organizations, such as those directed towards charitable, religious, scientific, literary or educational purposes. Organizations eligible to receive deductible contributions are sometimes referred to as “charitable” organizations, although many other types of entities, such as governmental entities and private foundations, are also eligible recipients.

Tax reform provides an opportunity to evaluate the effectiveness of charitable giving incentives and the tax benefits for organizations serving public interests. Following are several potential goals that could serve as guidelines for the Committee when reviewing the tax rules for exempt organizations and charitable contributions:

- Maximize the efficiency and effectiveness of any incentives for charitable giving that are retained or reformed
- Consider whether the availability of tax incentives for charitable giving should be broadened to more taxpayers
- More tightly align tax-exempt status with providing sufficient charitable benefits
- Closely examine the relationship between political activity and tax-exempt status
- Reconsider the extent to which tax-exempt organizations should be allowed to engage in commercial activity
- Improve the accountability and oversight of tax-exempt organizations

Some specific concerns related to the tax rules associated with tax-exempt organizations include the following:

- **Fairness:** The charitable deduction is an itemized deduction. Therefore, it is only available to the roughly one-third of taxpayers who itemize, although the standard deduction is supposed to take into account a certain amount of itemized deductions. Among taxpayers who itemize, the value of the charitable deduction is proportional to the taxpayer’s income tax bracket. Because the income tax brackets are progressive, this means that higher-income individuals get a larger benefit for a contribution of the same amount. According to CBO, the charitable deduction represents 0.7% of after-tax income for the highest quintile, but only 0.1% of after-tax income for the middle quintile. Some argue that allowing taxpayers to deduct charitable giving is appropriate because the donor is giving away the entire contribution without receiving anything tangible in return. Others argue that charitable giving incentives should be the same for all taxpayers.

- **Low bang-for-the-buck:** Tax incentives in this area could potentially achieve more at a lower cost. For example, according to CBO, providing an above-the-line deduction or refundable credit for charitable contributions above a certain percentage of the donor's income could lead to greater total charitable contributions at a lower cost. Some research also suggests that "matching" a taxpayer's charitable contributions by directing the tax incentive to the charity, rather than the donor, could increase total charitable giving at less cost. But some argue that governmental gift matching programs do not work well in practice. There also are questions as to its constitutionality with respect to religious organizations. In addition, other research suggests that simply cutting the charitable deduction without other reforms would reduce charitable giving.
- **Political activity:** Some tax-exempt organizations are allowed to engage in political activities. Some argue that tax-exempt organizations should not be allowed to engage in political activities, especially campaigning for or against a particular candidate, or that they should have to disclose their donors if they do so. Others argue that tax-exempt organizations should be allowed to engage in these activities with fewer or no restrictions and should not be required to disclose their donors.
- **Sufficient charitable benefit of tax-exempt organizations:** Theoretically, nonprofit organizations are granted tax-exempt status because they provide a benefit to the public, particularly to the poor and underserved. However, organizations that do not serve the needy can often claim tax-exempt status, and some tax-exempt organizations appear to serve private interests in the same way as for-profit corporations.
- **Commercial activity:** Some tax-exempt organizations engage in commercial activities, either as part of their tax-exempt purpose or through activities unrelated to their tax-exempt purpose which are then subject to the unrelated business income tax ("UBIT"). Some are concerned that this results in unfair competition with for-profit businesses, erosion of the corporate tax base, or managers focusing too little on the tax-exempt purpose of the organization.
- **Accountability and oversight:** There are approximately 1.5 million tax-exempt organizations with \$2.7 trillion in assets, and 29 different types of tax-exempt organizations. As with any large sector of the economy, there are instances of waste, fraud, and abuse. Some think more should be done to monitor charities, for example to ensure that they are not spending a large share of their donations on fundraising and large salaries for their founders.

REFORM OPTIONS

I. CHARITABLE DEDUCTION

Under current law, individuals and corporations may deduct contributions to charitable and certain other organizations for income tax purposes. Individual taxpayers may only deduct charitable contributions if they itemize rather than claiming the standard deduction. Charitable contributions are not, however, disallowed for purposes of the alternative minimum tax. In 2009, 27% of all taxpayers itemized and claimed the charitable deduction. Corporate and individual charitable giving totaled almost \$300 billion in 2011.

In addition, there are limits on how much charitable contributions taxpayers may deduct as a share of their income. As illustrated in the following table, individuals may only deduct up to 50% of their adjusted gross income (AGI) for most charitable contributions, and only up to 30% of their AGI for charitable contributions of capital gain property. For private foundations and certain other organizations, individuals may only deduct up to 30% of their AGI for most contributions and up to 20% of their AGI for contributions of capital gain property. C corporations may only deduct up to 10% of their taxable income, inclusive of all types of contributions.

General Limits on Charitable Deductions for Individuals as a Share of Their Adjusted Gross Income

	Gift to Public Charity	Gift to Private Foundation
Cash	50%	30%
Ordinary Income Property	50%	30%
Capital Gain Property	30%	20%

When contributing appreciated property, taxpayers are not required to pay capital gains tax on the gain on the property. Taxpayers generally may deduct the full fair market value of donated property. However, in certain cases, taxpayers can only deduct the lesser of the fair market value of the property and their “basis” in the property (which is typically how much they paid for it). For example, taxpayers may only deduct their basis in the property if the gain would be taxed at ordinary income rates, or if the property is not related to the charitable organization’s exempt purpose.

Taxpayers can only deduct contributions to a subset of tax-exempt organizations in the tax code. For example, they may deduct contributions to governmental entities, religious organizations, educational institutions, museums, and many others. They cannot deduct contributions to foreign organizations, most social welfare (501(c)(4)) organizations, labor

organizations (501(c)(5)), and chambers of commerce (501(c)(6)). According to the Joint Committee on Taxation, there are about 1.5 million tax-exempt organizations and about 1.1 million organizations eligible to receive deductible contributions (501(c)(3)). About 300,000 of these organizations are religious organizations. Some charities rely on contributions more than others. Health care and education charities rely relatively less on private giving and relatively more on fees for services, whereas religious, environmental, animal, and arts charities are relatively dependent on contributions. Others rely more on government grants for funding.

- 1. Repeal the charitable contribution deduction** ([Mitchell, "Should We End the Tax Deduction for Charitable Contributions?," Wall Street Journal, December 12, 2012](#))
- 2. Fundamentally reform the charitable contribution deduction**
 - a. Convert the deduction to a refundable or nonrefundable credit ([Joint Committee on Taxation, "Present Law and Background Relating to the Federal Tax Treatment of Charitable Contributions," February 2013](#))
 - i. Create a flat non-refundable credit of, for example, 12% of charitable contributions ([National Commission on Fiscal Responsibility and Reform, "The Moment of Truth," 2010](#))
 - ii. Replace the deduction with a refundable tax credit of, for example, 25% for all taxpayers ([Thiess and Fieldhouse, Our Fiscal Security, "Investing in America's Economy," 2010](#))
 - b. Structure any charitable incentive as a "match" that is paid directly to the charity
 - i. Repeal the deduction and provide charities with a matching grant in the form of a refundable credit equal to, for example, 15% of the donor's contribution ([Bipartisan Policy Center, "Restoring America's Future," November 2010](#); [Scharf and Smith, "The Price Elasticity of Charitable Giving: Does the Form of Tax Relief Matter?" Economic & Social Research Council, 2010](#))
 - ii. This option could also be coupled with the existing deduction, although that would entail more administrative complexity (similar to the law in the U.K.)
 - c. Cap the amount or value of the charitable deduction
 - i. Limit the value of the deduction to, for example, 28% per dollar deducted ([FY14 Administration Budget Proposal](#); [Congressional Budget Office, "Reducing the Deficit: Spending and Revenue Options," March 2011](#))

1. This would also be the result if the top rate were lowered ([H.R.3838 \(99th Congress\), The Tax Reform Act of 1986, sponsored by Rep. Rostenkowski](#))
- ii. Implement a maximum dollar cap on all itemized deductions, including the charitable deduction, of, for example \$50,000 cap on itemized deductions ([Sen. Corker, Summary of the Fiscal Reform Act of 2012](#))
- d. Allow non-itemizers to claim the charitable contribution deduction ([Testimony of Dr. Eugene Steuerle before the Committee on Ways and Means, February 14, 2013](#); [President's Advisory Panel on Federal Tax Reform, 2005](#))
- e. Focus the deduction on "traditional" charities, such as churches and homeless shelters, that support the needy ([Reich, "A Failure of Philanthropy," Stanford Social Innovation Review, 2005](#))

3. Attempt to increase the effect of charitable incentives on charitable giving

- a. Only provide tax incentives for charitable giving for contributions in excess of a certain percentage of the taxpayer's income
 - i. Only allow the deduction for charitable contributions in excess of, for example, 2% of the taxpayer's adjusted gross income ([Congressional Budget Office, "Reducing the Deficit: Spending and Revenue Options," March 2011; estimated in 2011 to raise \\$219 billion over 10 years](#))
 - ii. This option could be combined with proposals to convert the deduction to a credit ([National Commission on Fiscal Responsibility and Reform, "The Moment of Truth," 2010](#))

4. Incrementally reform the charitable contribution deduction

- a. Simplify the deduction
 - i. Repeal the limits on how much taxpayers may deduct as a share of their income ([H.R.2903 \(103rd Congress\), To... provide that the percentage limitations on the charitable deduction shall not apply to contributions for... disaster relief, and for other purposes, sponsored by Rep. Talent](#))
 - ii. Streamline the statutory language, clarify definitions, and remove deductions for contributions prone to abuse ([Halperin, "The Charitable Deduction Section 170 Reorganized," Urban Institute, 2012](#))
 1. For example, include all special valuation or measurement rules in section 170(a), and repeal deduction for donations of taxidermy and certain types of inventory

2. Consolidate the limits on how much taxpayers may deduct as a share of their income for contributions of appreciated property to charities and private foundations
- iii. Carve out the charitable deduction from the Pease limitation ([H.R.1479 \(113th Congress\), To... remove the deduction for charitable contributions from the overall limitation on itemized deductions, sponsored by Rep. Sensenbrenner](#))
- iv. Allow taxpayers to deduct charitable contributions for the previous tax year until April 15 of the following year, in order to coincide with tax filing deadlines ([Testimony of Dr. Eugene Steuerle before the Committee on Ways and Means, February 14, 2013](#))
- b. Limit deductions for non-cash contributions
 - i. Limit the deduction for all contributions of property to the lesser of the donor's basis in the property or the fair market value ([Joint Committee on Taxation, "Options to Improve Tax Compliance and Reform Tax Expenditures," January 2005](#))
 - ii. Allow unlimited deductions for the fair market value of all contributions of appreciated property, but require taxpayers to pay any applicable capital gains tax on the gain at the time of the contribution ([Halperin, "A Charitable Contribution of Appreciated Property and the Realization of Built-In Gains," Tax Law Review, 2002](#))
 - iii. Disallow the contribution of property unless it is of direct benefit to the charity ([Colinvaux, "Charitable Contributions of Property: A Broken System Reimagined," Harvard Journal on Legislation, 2013](#))
 - iv. Limit the deduction for clothing and household items to, for example, \$500 ([Joint Committee on Taxation, "Options to Improve Tax Compliance and Reform Tax Expenditures," January 2005](#))
 - v. Modify the rules regarding contributions of fractional interests in tangible personal property, including art ([Association of Art Museum Directors, Submission to Ways and Means Charitable/Exempt Organization Working Groups, 2013](#))
 - vi. Allow enhanced deductions for inventory property only in response to specific requests ([Kim and Hjorth, "Does Charity Begin at Home for Pharmaceutical Companies?" Tax Notes, October 2011](#))
- c. Expand deductions for non-cash contributions
 - i. Allow taxpayers to sell appreciated property without recognizing gain and receive a full charitable deduction if the entire sales proceeds are

- donated to a charity within 60 days of the sale ([President's Advisory Panel on Federal Tax Reform, 2005](#))
- ii. Make permanent the enhanced deduction for food inventory for all types of business entities, not just C corporations ([Feeding America comments to Committee on Ways and Means working group on Charitable/Exempt organizations, submitted April 15, 2013](#))
 - iii. Increase the standard mileage rate for individual automobile use by volunteers ([S.3246 \(110th Congress\) Fair Deal for Volunteers Act of 2008, sponsored by Sen. Grassley](#); [S.243 \(111th Congress\) GIVE Act of 2009, sponsored by Sen. Cardin](#))
- d. Disallow the charitable deduction for contributions made to support specific commercial activities
- i. Disallow the deduction for charitable contributions that are a prerequisite for purchasing tickets to sporting events ([Clotfelter, "Stop the Tax Deduction for Major College Sports Programs," Washington Post, December 31, 2010](#))
 - ii. Disallow the charitable deduction for contributions to support collegiate sports teams ([Congressional Budget Office, "Tax Preferences for Collegiate Sports," 2009](#))
 - iii. As discussed in Part II, disallow the charitable deduction as part of limiting tax-exempt status for organizations engaged in large amounts of commercial activity
- e. Modify the deduction for contributions of conservation easements
- i. Repeal the deduction ([Halperin, "A Better Way to Encourage Gifts of Conservation Easements," Tax Notes, July 2012](#))
 - ii. Make permanent the expanded deduction for contributions of conservation easements ([S.526 \(113th Congress\), The Rural Heritage Conservation Extension Act of 2013, sponsored by Sens. Baucus, Hatch, Stabenow, and others](#))
 - iii. Replace the deduction with a refundable tax credit, capped at an overall dollar amount ([Halperin, "A Better Way to Encourage Gifts of Conservation Easements," Tax Notes, July 2012](#))
 - 1. Could require a public agency, for example, the Bureau of Land Management, to allocate credits based on conservation value of the donated property
 - iv. Eliminate the deduction for:

1. Personal residences ([Joint Committee on Taxation, "Options to Improve Tax Compliance and Reform Tax Expenditures," January 2005](#))
 2. Forgone upward development of a historic building ([FY14 Administration Budget Proposal; estimated in 2013 to raise less than \\$1 billion over ten years](#))
 3. Partial interests in property to be used as a golf course ([FY14 Administration Budget Proposal; estimated in 2013 to raise \\$1 billion over ten years; S.526 \(113th Congress\), The Rural Heritage Conservation Extension Act of 2013, sponsored by Sens. Baucus, Hatch, Stabenow, and others](#))
- v. Strengthen qualification requirements for organizations receiving donated conservation easements
1. Require that the organization be certified by a public agency, for example the IRS, to receive conservation easements ([Halperin, "A Better Way to Encourage Gifts of Conservation Easements," Tax Notes, July 16, 2012](#))
 2. Suspend a land trust's ability to accept new donations if an audit reveals repeated failures to enforce easements or an unsustainable ratio of easements held to available resources ([Colinvaux, "The Conservation Easement Tax Expenditure: In Search of Conservation Value," Columbia Journal of Environmental Law, 2012](#))
- f. Make permanent or expand tax-free distributions from individual retirement accounts (IRAs) for charitable purposes ([S.557 \(112th Congress\), Public Good IRA Rollover Act of 2011, sponsored by Sen. Schumer](#))
- g. Reform reporting and valuation rules
- i. Require charities to report to the IRS gifts above, for example, \$600 to improve compliance ([President's Advisory Panel on Federal Tax Reform, 2005](#))
 - ii. Increase the threshold at which taxpayers are required to obtain qualified appraisals for non-cash contributions from \$5,000 to, for example, \$10,000 ([GAO, "Burdens on Taxpayers Could Be Reduced and Selected Practices Improved," 2012](#))
 - iii. Increase reporting requirements for enhanced deductions for inventory property ([Colinvaux, "Enforcing the Enhanced Charitable Deduction," Urban Institute, 2012](#))

II. TAXATION OF BUSINESS ACTIVITIES OF NONPROFITS

Generally, tax-exempt organizations, including charities, must be organized for a tax-exempt purpose. As a result, these organizations are allowed to participate in other activities only to a limited extent.

Charitable and tax-exempt organizations that engage in commercial activities may be subject to tax on the income from some portion of those activities. Trade or business income that is related to exempt activities (e.g., fee-for-service revenue) is generally tax-exempt, while trade or business income that is not related to the exempt purpose is generally taxable. Most tax-exempt organizations can operate an unrelated trade or business, so long as operating the trade or business is not the organization's primary activity or a substantial part of the organization's activities. For certain types of tax-exempt organizations, investment income is also taxable. In practice, some tax-exempt organizations create complex structures to coordinate and operate trade or business activities, including but not limited to for-profit subsidiaries and joint-venture partnerships.

When a tax-exempt organization regularly carries on trade or business activities that are unrelated to its exempt purpose, the income from those activities is generally subject to the unrelated business income tax (UBIT). There are some exceptions, however. For example, dividends, interest, rents and royalties (unless derived from debt-financed property) are generally exempt from UBIT. Special rules exist for income paid to a tax-exempt organization from a controlled for-profit business.

- 1. Tax all commercial activities of tax-exempt organizations** ([Testimony of John D. Colombo before the Committee on Ways and Means, July 25, 2012](#))
- 2. Revise the requirements for tax-exempt status for organizations engaged in commercial activity**
 - a. Disallow tax-exempt status for certain organizations engaged in business activities, such as credit unions, nonprofit hospitals or certain types of insurance firms ([Hodge, Tax Foundation, "Raising Revenue: The Least Worst Options," 2012](#))
 - b. In the case of fee-for-service nonprofits or charities, such as nonprofit hospitals and credit counseling organizations ([Colinvaux, "Charity in the 21st Century: Trending Toward Decay," Florida Tax Review, 2011](#)):

- i. Impose an affirmative requirement to provide service irrespective of ability to pay,
 - ii. Require a “reasonable” fee, and
 - iii. Require an independent governing body
 - c. Provide charities conducting commercial activity with more certainty of tax-exempt status
 - i. Clarify that commercial activities related to a tax-exempt purpose do not jeopardize tax-exempt status ([Testimony of John D. Colombo before the Committee on Ways and Means, July 25, 2012](#))
 - ii. Clarify that charities receiving a majority of their gross income from activities related to their mission are not at risk of losing tax-exempt status ([Pena and Reid, “A Call for Reform of the Operational Test for Unrelated Commercial Activity in Charities,” NYU Law Review, 2001](#))
 - d. Reform hospital requirements for tax-exemption
 - i. Require tax-exempt hospitals to provide a certain amount of charity care, for example 5% of operating expenses ([Sen. Grassley, Tax-Exempt Hospitals: Discussion Draft, 2007](#))
 - ii. Require joint-venture, for-profit hospitals to adopt charity care requirements ([Sen. Grassley, Tax-Exempt Hospitals: Discussion Draft, 2007](#))
 - e. Reassess the treatment of tax-exempt organizations providing insurance
 - i. Require that a fraternal beneficiary society, order, or association is exempt from tax only if no substantial part of its activities consists of providing commercial-type insurance ([Joint Committee on Taxation, “Options to Improve Tax Compliance and Reform Tax Expenditures,” January 2005](#))

3. Revise the UBIT rules for organizations engaged in commercial activity

- a. Classify certain activities as unrelated to any charitable mission and therefore subject to UBIT
 - i. Subject the income of university athletic programs to the UBIT ([Congressional Budget Office, “Tax Preferences for Collegiate Sports,” 2009](#))

- b. Expand exemptions from UBIT
 - i. Permanently extend the exemption from UBIT for exempt organizations receiving investment income from a controlling organization if such investment income is no more than the fair market value ([National Automobile Dealers Association comments to Committee on Ways and Means working group on Charitable/Exempt organizations, submitted April 15, 2013](#))
 - ii. Exempt “traditional” charities (i.e. those whose mission is exclusively to serve the poor) from UBIT rules so long as all income is being used to fund the primary purpose ([Kelley, “Rediscovering Vulgar Charity: A Historical Analysis of America’s Tangled Nonprofit Law,” Fordham Law Review, 2005](#))
- c. Modify the UBIT treatment of income from debt-financed activities
 - i. Exempt some established employee-funded pensions ([H.R.6056 \(111th Congress\), A bill...to treat certain employee-funded pensions...in the same manner as qualified trusts,..., sponsored by Rep. Neal](#))
 - ii. Allow tax-exempt organizations to directly invest in debt-financed securities and commodities (including certain hedge funds and other investment funds) without incurring UBIT ([H.R. 3970 \(110th Congress\), Tax Reduction and Reform Act of 2007, sponsored by Rep. Rangel](#))
 - iii. Establish a “look-through” rule to address the use of foreign “blocker” corporations to avoid the rules regarding debt-financed investment income ([Miller, “How US Tax Law Encourages Investment Through Tax Havens,” Tax Notes, 2011](#))

4. Tighten rules on conversion from tax-exempt to for-profit status

Under current law, charities are allowed to reorganize as for-profit entities, when doing so may avoid federal income tax on assets that are unrelated to their charitable mission.

- a. Tighten rules on conversion from tax-exempt to for-profit status, for example, by imposing a termination tax on the conversion of assets ([Joint Committee on Taxation, “Options to Improve Tax Compliance and Reform Tax Expenditures,” January 2005](#))

5. General reforms to tax-exempt entities

- a. Eliminate tax-exempt status of professional sports leagues under business leagues definition ([S.A.750, offered by Sen. Coburn, to S.743 \(113th Congress\), Marketplace Fairness Act of 2013, sponsored by Sen. Enzi](#))
- b. Allow mutual ditch and irrigation companies to receive a larger percentage of their income from leases and sales of certain real property without jeopardizing their tax-exempt status ([S.3650 \(112th Congress\), Ditch and Irrigation Company Tax Reform Act, sponsored by Sen. Udall](#))

III. POLITICAL ACTIVITY AND LOBBYING OF TAX-EXEMPTS

Some types of tax-exempt organizations may engage in lobbying or political activities. Lobbying involves attempting to influence Members of Congress, legislative staff or senior executive staff. Political activity involves participating in or intervening in political campaigns.

Section 501(c)(3) organizations are not allowed to participate in any political activities. In addition, “no substantial part” of their activities can involve lobbying. While the definition of “no substantial part” is not entirely clear, many believe that no more than approximately 5% to 10% of a 501(c)(3)’s activities may be comprised of lobbying. There is, however, a safe harbor where such organizations are allowed to spend up to \$1 million on lobbying activities. Section 501(c)(3) organizations are required to apply for exempt status. Donors to section 501(c)(3) public charities are not made public.

Section 501(c)(4) organizations (social welfare), (c)(5) organizations (labor unions) and (c)(6) organizations (trade associations) may participate in some political activity as long as that activity is not the organization’s primary activity. These groups can engage in unlimited lobbying activities as long as they relate to the organization’s tax-exempt purpose. These organizations may, but are not required to, apply for exempt status, and donors to these organizations are not made public.

Section 527 organizations are political organizations and may engage in unlimited political activities. At formation, these groups must give notice to the IRS within 24 hours. These organizations are required to make public donors making contributions of more than \$200 per person, per calendar year.

1. Limit political activity of 501(c)(4), (c)(5) and (c)(6) organizations

- a. Limit the amount of political election activity that such organizations may engage in to, for example, 10% of expenditures ([Congressional Letter to the Commissioner of the IRS, sent by Sen. Schumer and others, March 2012](#); [Colvin, "Political Tax Law After Citizens United: A Time For Reform," Tax Analysts, 2010](#))
- b. Require that such organizations disclose the amount and percentage of their total annual expenditures that go to influencing federal, state and local elections ([Congressional Letter to the Commissioner of the IRS, sent by Sen. Schumer and others, March 2012](#); [New York Office of the Attorney General, "A.G. Schneiderman Adopts New Disclosure Requirements For Nonprofits That Engage In Electioneering," June 2013](#))

2. Change the categories of tax-exempt organizations that may engage in political activities

- a. Create a new category for tax-exempt organizations engaged primarily in political activities ([Aprill, "Regulating the Political Speech of Non Charitable Exempt Organizations After Citizens United," Election Law Journal, 2011](#))
 - i. Add new requirements for 501(c)(4), (c)(5), and (c)(6) organizations regarding lobbying and political activity and clarify existing rules through statute
 - ii. Require 501(c)(4), (c)(5), and (c)(6) organizations to file a notice of application for exemption within a specified period
 - iii. Increase public disclosure of contributors to 501(c)(4), (c)(5), (c)(6) organizations and the new category of politically active tax-exempt organizations
 - iv. Tax political activities of 501(c)(4), (c)(5), and (c)(6) organizations and the new category of politically active tax-exempt organizations, regardless of whether the organization has investment income
- b. Eliminate 501(c)(4) organizations, but allow them to reapply for tax-exempt status under another existing category ([Colombo, "Do Away With Them," New York Times, May 15, 2013](#))
- c. Require an organization involved in any political campaigning to be a 527 organization ([Aprill, "Create a New Category," New York Times, May 15, 2013](#))
- d. Deny tax-exempt status to section 501(c)(5) labor unions if members' dues are used by a union in political campaign (S.A.416, offered by Sen. Bob Dole to H.R.13270, The Tax Reform Act of 1969)

3. Reform reporting and disclosure rules

- a. Require certain reporting by tax-exempt organizations involved in Federal election-related activity ([S.791 \(113th Congress\), The Follow the Money Act of 2013, sponsored by Sens. Wyden and Murkowski](#))
 - i. Impose an excise tax on tax-exempt organizations for failing to report to the Federal Election Commission certain contributions or expenditures
 1. Would apply to contributions or expenditures used to influence a nomination or election of an individual to any federal office
 2. Alternatively, revoke tax-exempt status for tax-exempt organizations failing to report such contributions and expenditures
 - ii. Require 527 organizations to file with the Federal Election Commission
 - iii. Deny business expense deductions for election-related activity expenditures by businesses that fail to report such expenditures to the Federal Election Commission
 - b. Ensure that members of tax-exempt organizations, including 501(c)(4), 501(c)(5), and 501(c)(6) organizations, are notified of the portion of their dues used for political and lobbying activities ([S.65 \(105th Congress\), A bill to... ensure that members of tax-exempt organizations are notified of the portion of their dues used for political and lobbying activities, sponsored by Sen. Hatch](#))
 - c. Require any tax-exempt organization supporting political activity to disclose donors ([Mayer, "Require Disclosure of Their Donors," New York Times, May 15, 2013](#))
 - d. Increase thresholds for reporting requirements for section 527 organizations ([Fei, "Less is More: A Proposal For Tax Simplification for Exempt Organizations' Political and Lobbying Activities," Nonprofit Law Matters, May 2013](#))
 - e. Tighten the rules relating to 501(c)(4), (c)(5) and (c)(6) organizations ([Mancino, "Don't Eliminate Them," New York Times, May 15, 2013](#))
 - i. Require such organizations to apply for tax-exempt status
 - ii. Require such organizations to disclose all donors, similar to private foundations who are required to make public donors
 - iii. Apply the gift tax to donations given to such organizations
- 4. Clarify that payments to 501(c)(4) organizations are excluded from the gift tax** ([Fei, "Less is More: A Proposal For Tax Simplification for Exempt Organizations' Political and Lobbying Activities," Nonprofit Law Matters, May 2013](#))

5. **Expand the prohibition on 501(c)(4) organizations engaging in lobbying from receiving any federal funds to include contracts** ([S.A.1842, offered by Sen. Craig to S.1060 \(104th Congress\), The Lobbying Disclosure Act of 1995, sponsored by Sen. Levin](#))

IV. BROAD TAX-EXEMPT ISSUES

Tax-exempt organizations must meet certain standards to maintain exempt status. Most tax-exempts are required to file annual information returns reporting gross income, disbursements and other information.

Generally, these organizations are subject to prohibitions against private inurement and private benefit. Under the private inurement prohibition, organizations are not allowed to use the organization's assets for the benefit of a person or entity with a close relationship to the organization. In addition, 501(c)(3) organizations are prohibited from serving private interests unless the private benefit is extremely small. For 501(c)(3) and (c)(4) organizations, an excise tax is imposed when the organization provides a closely related party with an "excess benefit".

Certain rules apply based on the type of charity. Charities (i.e., organizations eligible to receive deductible contributions) are broken down into two categories: public charities and private foundations. An organization is treated as a private foundation unless it meets one of several tests for the more favorable public charity status. To be a public charity, an organization must either be: (1) a certain kind of organization, such as a church, hospital, or governmental unit, (2) broadly supported by the public, (3) a supporting organization, or (4) a public safety organization. An organization is broadly supported by the public if at least one-third of its funding comes from the public or governmental, or from the public and revenue from activities related to the charitable purpose. Private foundations generally have one donor or a small group of donors.

Private foundations are subject to several requirements and operational restrictions that do not apply to public charities. For example, private foundations must distribute 5% of their assets each year. They also must pay a 2% tax on their net investment income each year. This tax is lowered to 1% if the foundation meets distribution requirements. In addition, the IRS and the private foundation must make public the foundation's donors.

1. Reform the taxation of private foundations

- a. Replace the two rates of net investment income excise tax on private foundations with a single tax rate of, for example, 1.40% ([FY14 Administration Budget Proposal; estimated in 2013 to cost \\$54 million over 10 years; S.593 \(112th Congress\), To amend the Internal Revenue Code to modify the tax rate for excise tax on investment income of private foundations, sponsored by Sen. Schumer](#))
- b. Relax the rule prohibiting private foundations from owning more than 20% of a for-profit corporation if the foundation acquires the business through gift or bequest, the foundation is independent of the donor's family, and the for-profit corporation distributes all of its net profits to the foundation ([S.3377 \(112th Congress\), Philanthropic Enterprise Act of 2012, sponsored by Sens. Lieberman and Snowe](#))

2. Reform the taxation of endowments

- a. Require tax-exempt organizations with endowments to spend an amount equal to at least their ten-year average compounded rate of return on their endowment minus the inflation rate minus 1 percentage point ([Vedder, Center for College Affordability and Productivity, "Federal Tax Policy Regarding Universities: Endowments and Beyond," 2008](#))
- b. Require tax-exempt organizations with endowments to distribute at least, for example, 5% of the endowment's value each year ([Testimony of Lynne Munson before the Finance Committee, July 25, 2012](#))

3. Ensure that donor-advised funds and supporting organizations are directing resources for charitable purposes in a timely fashion

Under current law, donor advised funds (DAFs) and supporting organizations are public charities that often have some donor involvement similar to private foundations. An individual may make an irrevocable gift to a DAF and receive the charitable contribution deduction. The fund then makes grants to charities on the advice of the individual donor. Supporting organizations are charities that support other exempt organizations, usually other public charities.

- a. Impose a minimum payout requirement of, for example, 5% ([Finance Committee discussion draft on proposals for reforms and best practices in the area of tax-](#)

[exempt organizations, 2004](#); [Hussey, “Avoiding Misuse of Donor Advised Funds,” Cleveland State Law Review, 2010](#))

- b. Require that all assets be distributed within a specified time frame of, for example, seven years ([Madoff, “Tax Write-Off Now, Charity Later,” New York Times, November 21, 2011](#))

4. Limit executive compensation by tax-exempt organizations

- a. Further define what constitutes a private benefit as a result of charitable activities by, for example, tightening rules for revenue generated in coordination with for-profit partnerships ([Testimony of John D. Colombo before the Committee on Ways and Means, July 25, 2012](#))
- b. Modify the standard under the section 4958 excess benefit provision to apply a “reason to know” standard and replace the rebuttable presumption rule with a minimum due diligence requirement. Apply an excise tax at the entity level. Require disclosure of compensation studies. ([Sen. Grassley, “Grassley Releases Review of Tax Issues Raised by Media-Based Ministries,” 2011](#); [Sen. Grassley, Amendment #F-8 to the American Healthy Futures Act, during mark-up of what would become the Patient Protection and Affordable Care Act](#))

5. Reform reporting requirements

Under current law, most tax-exempt organizations are required to make public their annual information reporting document on the Form 990. Tax-exempts are not required to make public the form where they disclose information about their commercial business unrelated to their mission, which is called the Form 990-T.

- a. Require tax-exempt organizations to make public their Form 990-Ts ([Joint Committee on Taxation, “Options to Improve Tax Compliance and Reform Tax Expenditures,” January 2005](#))
- b. Require electronic filing for all 990 forms ([Center on Nonprofits and Philanthropy \(and others\), “Statement submitted to the Committee on Ways and Means,” July 25, 2012](#))
- c. Allow charities with up to \$1 million in gross receipts to file a simpler form than the Form 990 ([Testimony of Eve Borenstein before the Committee on Ways and Means, July 25, 2012](#))

- d. Require an abbreviated IRS reporting requirement or a requirement to alert the IRS of an organization's intent to claim church status ([Finance Committee staff memorandum to Sen. Grassley, "Review of Media-Based Ministries," January 2011](#))
6. **Develop enforcement methods other than revocation of tax-exempt status as the only penalty for noncompliance** ([Finance Committee staff memorandum to Sen. Grassley, "Review of Media-Based Ministries," January 2011](#))