Summary of and Comments on Exempt Organization Provisions of the Tax Reform Act of 2014

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Introduction

- On February 26, 2014, Dave Camp, Chairman of the Ways and Means Committee of the US House of Representatives, released the Tax Reform Act of 2014 as a discussion draft ("Camp draft"). The Camp draft includes many proposals that would affect organizations exempt from federal income tax, including proposals to change the charitable deduction, unrelated business income tax rules, excise taxes, and various administrative provisions.
- These slides summarize all the exempt organization–related proposals in the Camp draft and comment on most provisions.
- The slides contain revenue estimates (the "scores") as provided by the Joint Committee on Taxation. The scores show the revenue gain or loss over 10 years.
- In general, although the Camp draft takes a holistic approach to tax reform, many of the exempt organization proposals are severable. Thus, it should be assumed that any one provision could be enacted independently.
  - For example, the America Gives More Act (H.R. 4619), which passed the House, contains some provisions from the Camp draft.
- Additional information about tax policy and charitable organizations is available on the Tax Policy and Charities website, a joint project of the Urban Institute and the Urban-Brookings Tax Policy Center, at http://www.urban.org/taxandcharities/.

Charitable Contributions

- **Proposal:** Two-percent floor on charitable deduction for individuals.
  - No deduction is allowed for charitable contributions below 2 percent of an individual's modified adjusted gross income (AGI).
    - A stacking rule applies (e.g., the contributions disallowed by the floor generally follow the order of the percentage limitations, with the lower percentage limited contributions the first disallowed).
  - *Score:* Not available.
  - *Comments:*
    - In general, a floor disallows contributions that might have been made without the incentive, while preserving the incentive effect in the margin. Thus, many argue that a floor is a cost-effective change.
      - A floor generally is consistent with either of the main theories supporting the charitable deduction (the base-defining or subsidy theories).
    - The Camp draft also proposes a substantial increase in the standard deduction (see next slides); as a result, only 5 percent of taxpayers likely will itemize. Thus, the direct impact of the floor in the number of taxpayers affected is limited. However, as with other proposals, the floor should be viewed as severable from the increase to the standard deduction.
    - The Camp draft also changes the percentage limitations so the same limits apply to gifts of ordinary income and capital gain property.
      - Consideration should be given to a stacking rule that first disallows in-kind contributions.
    - Committee staff predict that charitable giving will increase under the Camp draft as a whole by $2.2 billion a year. These increases appear to be tied to assumptions about economic growth resulting from the Camp draft rather than to direct effects of the proposal.
    - Some argue that a floor will lead to bunching of contributions in a single year to avoid multiple applications of the floor.
    - A floor has administrative and compliance benefits, eliminating the need to track and substantiate many contributions, including many hard-to-value contributions of property.

Charitable Contributions

- **Proposal:** Increase the amount of the standard deduction, reducing eligibility for the charitable deduction from roughly 33 percent of taxpayers to just 5 percent.
  - *Comments:*
    - The proposal eliminates the charitable deduction as an incentive for most taxpayers.
    - The proposal appears to embrace a base-defining view of the charitable deduction, namely that a separate incentive or subsidy for charitable contributions is widely unnecessary. Rather, individuals have reasons apart from tax policy to make charitable contributions and will make them regularly without a tax incentive (as nonitemizers do today). Thus, part of the Camp draft's increase to the standard deduction is to account for charitable contributions, continuing the present-law effect of removing charitable contributions from the tax base. In this sense, the proposal likely is not intended as a cut to the charitable deduction.
      - Nevertheless, many will argue that eliminating the incentive for most taxpayers will significantly decrease charitable giving, harming the ability of 501(c)(3) organizations to market the deduction as a reason to give.
      - The ultimate impact of the proposal on giving depends on how large a role a tax incentive plays in facilitating the decision of whether to give, and of how much to give. By increasing the cost of giving to taxpayers, some who now give might reduce their giving by roughly the amount of the current-law subsidy.
      - Yet, supporters of the proposal would argue that the impact on giving is unlikely to be significant because individuals make charitable contributions for many reasons (e.g., charitable impulse and the personal desire to help others), and the tax incentive plays a small overall role in the reason people give.
      - Further, the impact of the proposal on giving should be seen in the context of the various sources of support for the 501(c)(3) sector. In the aggregate, private giving (including giving by nonitemizers) accounts for roughly 12 percent of total support for the sector. Thus, any reduction in giving resulting from the proposal would be a reduction of one source of support.
        - » Some organization types, however, rely on private giving more and likely rely on the incentive as a fundraising tool more than others; these types would be disproportionately affected.
    - By substantially reducing the number of taxpayers claiming charitable contributions, the proposal considerably simplifies tax filing, eliminating the need to track, substantiate, and audit many contributions.

Charitable Contributions

- *Comments, continued:*
  - The proposal to increase the amount of the standard deduction partly retains the incentive effect of the charitable deduction by allowing the deduction (with a 2 percent AGI floor) for the 5 percent of taxpayers who will still itemize deductions.
  - Preserving the charitable deduction for just 5 percent of taxpayers targets the incentive to donors capable of making the largest gifts—that is, the wealthiest taxpayers.
    - Some would argue that this is appropriate because the incentive (i.e., the tax savings) has the greatest effect on large planned contributions by the most affluent. Thus, retaining the incentive for this group arguably preserves the incentive where it really matters and will have the most beneficial impact for 501(c)(3) organizations.
    - However, a charitable incentive for a small percentage of the wealthiest taxpayers raises **new policy concerns**.
      - » As a subsidy, the charitable deduction has been justified as encouraging giving or altruistic behavior generally—that is, giving for giving's sake. The deduction also has been justified as a way to allow private individuals directly to allocate taxpayer (subsidy) dollars. An incentive targeted to 5 percent of taxpayers essentially rejects both these rationales, as the only giving or private allocation provided by the incentive would be to a small percentage of taxpayers.
      - » There have been concerns that the charitable deduction even in its present form is not neutral: organizations that benefit the most are those preferred by itemizers. For example, if itemizers favor giving to their alma mater over providing for basic needs, universities are better served by the deduction than basic-needs charities. By reducing the pool of itemizers, the proposal exacerbates the effect of subsidizing the charitable choices of a small percentage of taxpayers.
      - » These policy concerns mean that the proposal would usher in a very new vision for the charitable deduction.
    - In summary, the proposal to increase the standard deduction views charitable deductions as appropriately outside the tax base. The proposal also finds it important to subsidize or encourage contributions by keeping the charitable deduction as an itemized deduction. The result will be a charitable deduction for just 5 percent of taxpayers.
    - A significant policy question then is raised, namely the purpose of the remaining subsidy. Is the purpose merely to subsidize the giving choices of the 5 percent of itemizers? This policy outcome would seem flawed. Assuming the basic framework of the proposal continues, a next iteration of the proposal should consider better targeting the intended public benefit of the subsidy by focusing on eligible donee organizations.

Charitable Contributions

- **Proposal:** Charitable contributions allowed until April 15.
  - *Score:* Not available.
  - *Comments:*
    - The proposal could result in increased charitable giving. Charities likely would market the tax incentive at the time individuals file taxes, resulting in new contributions. This increase could be offset to some degree by reduced contributions at the end of the calendar year.
    - The proposal likely would have limited impact when combined with the Camp draft's increase to the standard deduction (i.e., not as a stand-alone provision). The 5 percent of taxpayers that would claim a charitable deduction generally are well advised about year-end giving and likely to be unresponsive to a timing change in terms of spurring new giving.
    - The proposal allows taxpayers to elect in which year to claim a charitable contribution made before April 15, as provided by the Secretary of the Treasury. Double counting of contributions in multiple tax years is a concern.
    - The proposal already has been severed from the Camp draft, passing the US House as part of H.R. 4619, and scored at a cost of $2.8 billion.

Charitable Contributions

- **Proposal:** Deduction for contributions of appreciated property limited to basis, with exceptions. Special enhanced deductions for food and book inventory are repealed.
  - Notwithstanding the general rule, the proposal continues to allow a fair market value–based deduction for
    - publicly traded stock (up to 10 percent of outstanding stock);
    - related use tangible personal property;
    - conservation contributions (generally known as easement contributions);
    - inventory for the benefit of the ill, needy, or infants (which may include food inventory); and
    - scientific property used for research.
  - *Score:* Not available.
  - *Comments:*
    - Because of the many exceptions, the proposal appears to apply mainly to privately traded securities and real property, so it could be expected to reduce contributions of these property types, both of which present valuation concerns and questions about the ultimate benefit inuring to the donee organization.
    - By moving to a basis deduction, the proposal eliminates (for affected property) an arguably unwarranted deduction for untaxed appreciation.
      - However, by continuing to allow a deduction for the untaxed appreciation of many types of capital gain property, the proposal perpetuates the preference for in-kind over cash contributions, and may not be cost-effective (i.e., the amount of the subsidy need not be fair market value but could be reduced, even if not to basis).
    - The proposal does not apply to depreciated property, and so generally would not change the rules for contributions of clothing and household items or vehicles.
      - However, interaction of the proposal with the increase in the standard deduction and the 2 percent floor would reduce the number of deductions allowed for such contributions, which present valuation and administrative challenges.

Charitable Contributions

- **Proposal:** Modification of percentage limitations.
  - The proposal combines the two percentage limits for contributions to public charities (the general 50 percent limit and the 30 percent capital gain property limit) to one 40 percent limit. The proposal also combines the two percentage limits for contributions to nonoperating private foundations (the general 30 percent limit and the 20 percent capital gain property limit) to one 25 percent limit.
  - *Score:* Not available.
  - *Comments:*
    - The proposal maintains the preference for public charity gifts over private foundation gifts.
    - The reduction in the percentage limitations accelerates deductions for some taxpayers, and it may counter slightly the effect of the floor for taxpayers subject to the present-law cap.
    - By reducing the number of percentage limitations from four to two, the proposal is a simplification.
    - The simplification comes at the cost of eliminating within the public charity and private foundation categories the preference for cash gifts over in-kind.
      - Thus, taxpayers with property to give (especially publicly traded securities) should be expected to give property instead of cash, which could reduce the net benefit inuring to the charity from the contribution.
      - The interaction of the percentage limit proposal, the retention of a fair market value–based deduction for publicly traded securities, and the fact that only 5 percent of taxpayers will claim the charitable deduction could further test perceptions of the charitable deduction as a tax benefit for the most affluent.
    - Consideration should be given to percentage limitations that favor cash over in-kind giving (whether of capital gain or ordinary income property).

Charitable Contributions

- **Proposal:** Qualified conservation contributions.
  - The proposal makes permanent the special rules for qualified conservation contributions (a.k.a., easements) that provide for increased percentage limits and longer carryforward periods.
  - The proposal provides that property used or intended to be used as a golf course is not eligible as a conservation contribution.
  - *Score:* Not available.
  - *Comment:* Some would argue that conservation contributions should not be treated more favorably than other charitable contributions. The deduction for easements is resource intensive and can be prone to abuse; so, arguably, favorable rules should not be extended. The bar on "golf course easements" may be sensible but other areas of concern remain unaddressed, including easement valuation, uncertain public benefit from easement contributions, and non-perpetual easements.

Charitable Contributions

- **Proposal:** Repeal of special quid pro quo rule allowing 80 percent deduction of payments made in exchange for tickets to college athletic seating events.
  - *Score:* Not available.
  - *Comment:* The special rule of present law allows a charitable deduction even though a donor receives considerable value (tickets) in exchange for the contribution. This runs counter to the general bar on contributions made for a quid pro quo. Thus, although repeal of the special rule may be appropriate, the proposal may invite valuation disputes. An alternative approach might be dramatically to limit the deduction percentage or affirmatively to disallow the deduction in this context altogether.

Charitable Contributions

- **Proposal:** Repeal of additional charitable deduction for intellectual property based on income to the charity from the contributed property.
  - *Score:* Not available.
  - *Comments:*
    - The proposal would essentially repeal a compromise enacted in 2004 that was necessary in order to change the fair market value deduction then allowed for intellectual property contributions to the general basis rule of present law. The compromise allowed donors to take additional charitable deductions in future if the intellectual property contribution generated income for the donee. The proposal eliminates the additional deduction and preserves the basis rule.
    - The proposal simplifies the law by closing the charitable deduction as of the contribution date, as is the norm.
    - The proposal also is consistent with the Camp draft's separate proposal to allow just a basis deduction for some other contributions of capital gain property.

Unrelated Business Income Tax (UBIT)

- **Proposal:** Name and logo royalties treated as unrelated business taxable income (UBTI).
  - *Score:* Gain of $1.8 billion.
  - *Comments:*
    - The issue of whether income from the licensing of an exempt organization's name and logo is active or passive has a history in case law. Courts have struggled with whether exempts provide services (resulting in taxable income) or play a passive role (resulting in exemption). In general, courts have accepted the passive, tax-free characterization depending on how the arrangement is structured.
    - The proposal to tax name and logo royalties likely stems from concerns relating to the AARP, on which the Ways and Means Oversight Subcommittee held hearings.
    - Pro:
      - Provides a bright line in a gray area. The proposal does not ban licensing arrangements but merely imposes taxation in an area where the distinction between passive and active income is unclear.
      - Some argue that logo relationships with for-profit companies distract exempt organizations from mission and can taint the exempt brand. Discouraging such relationships may lead to improved focus on exempt purposes.
    - Con:
      - Some argue that cause-related marketing has beneficial effects for good causes and so should not be discouraged.
      - Proposal would reduce the revenue of some exempt organizations.

Unrelated Business Income Tax (UBIT)

- **Proposal:** Modify rules concerning qualified sponsorship payments.
  - The proposal would treat as UBTI payments to an exempt organization (EO) if the EO uses or acknowledges a sponsor's products. A special rule eliminates the UBTI exemption for exclusive sponsorships over $25,000 and requires uniform presentation for non-exclusive sponsorships over $25,000.
  - *Score:* Gain of less than $50 million.
  - *Comments:*
    - The proposal sets a bright line on what constitutes advertising, concluding that acknowledgment of products is advertising and thus should be subject to UBIT.
    - Some might argue that a simpler approach would be to eliminate the qualified corporate sponsorship exemption altogether.
    - Pro:
      - Some would argue that the proposal reflects reality: EOs that acknowledge commercial products for a fee are engaged in advertising. The proposal thus reinforces UBIT rules (which generally treat advertising as UBTI), and protects EO brands from commercial taint.
    - Con:
      - The proposal will reduce the revenue of some EOs and likely will discourage for-profit corporate relationships.

Unrelated Business Income Tax (UBIT)

- **Proposal:** Unrelated business taxable income computed separately for each trade or business.
  - *Score:* Gain of $3.2 billion.
  - *Comments:*
    - The proposal likely stems from the IRS's study of colleges and universities.
    - The proposal might encourage EOs to conduct unrelated businesses through a controlled subsidiary, which may not be subject to the basketing rules of the proposal. Thus, the proposal might be of limited impact.
    - The proposal raises the issue of whether unrelated businesses, though generally allowed, should be discouraged as a matter of policy.
    - The proposal might better focus EO managers on whether to continue in loss-generating unrelated businesses.
    - Relatedly, the proposal might encourage better recordkeeping, but likely would come with additional reporting burdens.
    - The proposal would appear to treat EOs worse than for-profits.

Unrelated Business Income Tax (UBIT)

- **Proposal:** Limit the UBTI exclusion for research income to publicly available research.
  - *Score:* Gain of $700 million.
  - *Comment:* Current law allows an exclusion from UBTI for research income by organizations engaged in publicly available fundamental research. The proposal appears to reflect a concern that the exclusion is too broad and should not apply to all research of such organizations.

Unrelated Business Income Tax (UBIT)

- **Proposal:** Increase the specific deduction against unrelated business taxable income from $1,000 to $10,000.
  - *Score:* Loss of $300 million.
  - *Comments:*
    - Many would argue that an increase to the specific deduction is long overdue.
    - An alternative would be to index the specific deduction to inflation.

Unrelated Business Income Tax (UBIT)

- **Proposal:** Parity of charitable contribution limitation between trusts and corporations for purposes of computing unrelated business taxable income.
  - *Score:* Negligible revenue effect.
  - No comment.

- **Proposal:** Clarification of unrelated business income tax treatment of entities exempt from tax under section 501(a).
  - Proposal clarifies that imposition of UBIT trumps exclusions provided elsewhere in the Code (e.g., the exclusion for income of states and municipalities).
  - *Score:* Gain of $100 million.
  - No comment.

Penalties

- **Proposal:** Increase in information return penalties.
  - Proposal doubles the amount of per day filing-related penalties, including the failure to file a return penalty; the penalty relating to the public availability of the Form 990, Form 1023, and Form 990-N; charitable trust returns; terminating filings; and reportable transaction reports.
  - *Score:* Gain of $100 million.
  - *Comments:*
    - Similar to the approach taken by Pension Protection Act of 2006, which doubled various excise tax rates.
    - Proposal reflects long-standing concern about lack of compliance.
    - Proposal does not double the overall penalty caps, just the daily rates.
    - Existing exceptions to the extent applicable (e.g., reasonable cause) are unchanged.

Penalties

- **Proposal:** Manager-level accuracy-related penalty on underpayment of unrelated business income tax.
  - Penalty is on EO manager(s) (with joint and several liability) equal to 5 percent of the underpayment, capped at $20,000.
  - Separate penalty on manager(s) for understatements relating to reportable transactions (10 percent of understatement, $40,000 cap, joint and several liability).
  - *Score:* Negligible revenue effect.
  - *Comments*
    - Proposal seems clearly directed to concern about UBIT allocations and deliberate understatement of UBIT liability and is consistent with the proposal to basket losses from unrelated businesses.
    - As with other UBIT proposals, the proposal may reflect a policy of discouraging unrelated trade or businesses by EOs, thus intending that EOs focus more on exempt purposes.
    - Pro:
      - The proposal should encourage more careful UBIT reporting.
    - Con:
      - The definition of "manager" potentially is vague, including a person "under a duty to perform an act in respect of which the underpayment occurs."
      - The proposal might be unfair, depending on how this penalty compares to penalties on managers of for-profit businesses.
      - The proposal might discourage people from becoming managers of EOs with unrelated businesses.

Excise Taxes

Proposal: Modification of taxes on excess benefit transactions (EBT).

- In general, under present law, excise taxes apply if a 501(c)(3) or 501(c)(4) organization provides an "excess benefit" to an insider of the organization.
- The proposal contains five distinct proposals, detailed below.
- *Score* (for all five proposals): Negligible.

- **The first EBT proposal** imposes a new tax on the EO for engaging in an excess benefit transaction. The tax is equal to 10 percent of the excess benefit.
  - There is no tax if the EO meets certain minimum standards of due diligence for the transaction.
  - *Comments:*
    - A policy question is whether the entity should be punished for the transgressions of individual actors.
    - Taxing the entity reduces funds available for exempt purposes.
    - It is unclear whether an entity-level tax will have any deterrent effect on insiders or foundation managers, both of which are already subject to excise taxes for knowingly providing excess benefits, and so may not alter their behavior if, in addition, the entity faces a tax.

Excise Taxes

- **The second EBT proposal** converts the rebuttable presumption of reasonableness (which, if followed under present law, provides some protection against imposition of excise taxes) into the minimum standards of due diligence. Under the proposal, an organization that followed the current law procedures (generally, advance approval by independent directors, reliance on appropriate data, and documentation of decision) would have a defense against the new entity-level tax, but following the procedures no longer would provide a presumption as to the reasonableness of the transaction for purposes of imposing the tax on insiders or managers.
  – *Comments:*
    - A presumption that a transaction is reasonable when a process is followed places emphasis on process over substance and arguably makes it harder for the IRS to attack excess benefits, especially unreasonable compensation. By eliminating the presumption, the proposal thus gives the IRS more leverage.
      – Nevertheless, success ultimately depends on whether the IRS has the resources and the commitment to attacking EBTs.
    - Organizations still would have an incentive to follow best practices (i.e., the rebuttable presumption process) to protect against the entity-level tax.
    - If the proposal is enacted but not the entity-level tax, organizations might have less reason to follow best practices.
      – However, best practices likely would remain legally relevant to substantive determinations, especially to protection against the manager tax.

Excise Taxes

- **The third EBT proposal** weakens the effect of relying on professional advice and the rebuttable presumption process with respect to the tax on EO managers for "knowing" EBT violations.
  - *Comments:*
    - Pro:
      - The proposal strengthens the IRS's ability to impose the manager tax by eliminating a process-based defense to imposition of the tax.
      - The proposal does not make professional advice irrelevant, but it removes a safe harbor.
    - Con:
      - The proposal might discourage people from serving as managers because of increased exposure to the excise tax.
    - The proposal might, in some cases, discourage managers from seeking professional advice. However, well-intentioned managers would still have every reason to consult professionals on difficult questions.

Excise Taxes

- **The fourth EBT proposal** treats investment advisors and athletic coaches as insiders—that is, as disqualified persons (DQPs).
  - *Comments:*
    - Investment advisors already are considered DQPs in the donor-advised fund context; thus, the proposal expands on existing concerns about excess benefits flowing to EO investment advisors.
    - The proposal favors a bright-line approach to the current facts-and-circumstances–based definition of a DQP, which includes persons with "substantial influence" over the EO.
      - Such bright-line definitions arguably undermine the policy behind the current DQP definition—that is, that excise taxes should apply only when people have "substantial influence" over the organization and thus, arguably, may be directing the excess benefit.
      - But, the proposal also highlights the weakness of the facts-and-circumstances approach, in that some transactions may escape scrutiny if a prominent figure, despite his or her prominence, nevertheless does not have "substantial influence."
    - Treating athletic coaches as DQPs apparently reflects the desire to give the IRS authority to review the compensation of coaches for reasonableness.
    - The Camp draft contains a separate proposal to tax compensation above $1 million for top-five employees. The interaction between these two taxes should be considered.
    - This proposal, combined with others, will likely create considerable uncertainty as to the appropriate compensation level for investment advisors and athletic coaches.
    - In general, the proposal puts the IRS in an awkward position of defending (through inaction) or attacking high-profile compensation cases, even though the proposal does not change the criteria for "reasonable" compensation.

Excise Taxes

- **The fifth EBT proposal** applies the EBT regime (intermediate sanctions) to 501(c)(5) and 501(c)(6) organizations (labor unions and trade associations).
  - *Comments:*
    - Pro:
      - Intermediate sanctions already apply to 501(c)(4) organizations, so, arguably, extending the sanctions to 501(c)(5) and 501(c)(6) organizations is a minor policy shift.
      - Both 501(c)(5) (by regulation) and 501(c)(6) (by Code) organizations are subject to the "no private inurement" rule, which intermediate sanctions were designed to enforce.
      - Misuse and/or concern about 501(c)(5) and 501(c)(6) organizations has been a news item; arguably, the IRS needs additional sanctions to help police these organizations.
    - Con:
      - Intermediate sanctions were designed mostly with 501(c)(3) organizations in mind. 501(c)(4) organizations arguably were included because of the public benefit associated with their exempt status (the promotion of "social welfare"). By contrast, 501(c)(5) and 501(c)(6) organizations are less clearly public benefit organizations, so the need to police "excess" benefits may not be as strong.
      - The proposal gives the IRS more regulatory authority over 501(c)(5) and 501(c)(6) organizations, although the public benefit given to these groups in terms of the subsidy provided and the exempt purposes achieved may not be as substantial or important as that provided to and by 501(c)(3) organizations.
      - The proposal raises the question of whether an intermediate sanction is the right remedy for violation of the private inurement proscription in this context. Revocation of exemption and taxable status might be more appropriate.
    - A policy issue is raised whether excess compensation should be different in the 501(c)(5) and 501(c)(6) contexts than in the 501(c)(3) context.

Excise Taxes

- **Proposal:** Modification of taxes on self-dealing by private foundations.
  - For acts of self-dealing between a private foundation and an insider, the proposal imposes a tax on the private foundation of 2.5 percent of the amount of self-dealing (10 percent if the act of self-dealing is excess compensation).
  - The proposal weakens the effect of reliance on professional advice with respect to the tax on foundation managers for “knowing” self-dealing violations.
  - *Score:* Negligible.
  - *Comments:*
    - As with public charities, it may be questioned whether the entity (and so ultimately foundation beneficiaries) should be punished for the self-dealing of individuals. It may also be questioned whether a tax on the entity will deter bad actors.
    - As with intermediate sanctions, the proposal arguably strengthens the IRS’s ability to impose the manager tax by eliminating a process-based defense to imposition of the tax.
    - The proposal does not make professional advice irrelevant, but it removes a safe harbor.
    - The proposal might discourage some from serving as managers and might discourage managers from seeking professional advice in some cases. However, as with intermediate sanctions, well-intentioned managers would still have every reason to consult professionals on difficult questions.

Excise Taxes

- **Proposal:** Impose an excise tax on the failure to distribute within five years a contribution to a donor-advised fund (DAF).
  - The tax equals 20 percent of the undistributed amount.
  - Distributions must be to public charities (not including supporting organizations or DAFs).
  - *Score:* Gain of less than $50 million.
  - *Comments:*
    - The proposal is a response to a concern that contributions to donor-advised funds accumulate and that payments for exempt purposes are delayed.
    - The five-year payout reflects an idea that DAFs should differ categorically from private foundations, which have a perpetual life.
    - The proposal treats all DAFs the same, whether sponsored by an investment firm or run by a community foundation. However, a five-year payout likely has different effects depending on the type of sponsoring organization.
    - The proposal might discourage contributions to DAFs in favor of distributions to operating charities.
    - Payout is much higher than for private foundations, which might lead DAFs to opt-in to private foundation treatment.
    - Broadly, the proposal raises the policy question of whether donor-advised funds should be encouraged as a giving vehicle, or whether the increasing use of DAFs undermines direct giving to more traditional charities, thus diluting the impact of charitable dollars.

Excise Taxes

- **Proposal:** Simplification of excise tax on private foundation investment income.
  - The proposal imposes a flat tax rate of 1 percent on the net investment income of private foundations (versus the two rates of present law).
  - The proposal also imposes this tax on private operating foundations, which currently are exempt.
  - *Score:* Loss of $1.6 billion.
  - *Comments:*
    - Proposal should result in increased payout for some foundations.
    - Proposal has long been sought by the foundation community.
    - The tax was enacted in 1969 with the intent that proceeds would fund IRS oversight of exempt organizations. The tax has never been so used. As a part of tax reform, the tax should be reconsidered.
      - Having never served its purpose, the tax could be eliminated.
      - Or, new efforts to use the tax to fund IRS operations could be made.
      - Or, new rationales could be developed in support of a tax on investment income. If so, the scope of the tax could be extended beyond private foundations, which is proposed elsewhere in the Camp draft.
    - The rationale for extending the tax to private operating foundations is unclear.
      - Private operating foundations are exempt from the investment income tax, presumably for similar reasons that public charities are exempt. As operating entities, the nature of their activities generally is not to accumulate income. However, by imposing the tax on one category of operating EO, the proposal arguably opens the door to taxation of investment income of public charities and noncharitable exempt organizations.
      - Relatedly, if operating foundations are subject to the tax, other organizations that are like private foundations, such as donor-advised funds, could also be subject to the tax.

Excise Taxes

- **Proposal:** Repeal of exception for private operating foundations from failure-to-distribute-income rules.
  - Proposal would subject private operating foundations to the general private foundation 5 percent payout.
  - *Score:* Negligible.
  - *Comments:*
    - The rationale for the proposal is unclear. Private operating foundations are by definition operating a program and so should already be "paying out."
    - The proposal, combined with imposition of the investment income tax to operating foundations, could lead to the elimination of the operating foundation category.
    - Proposal would increase compliance burdens of operating foundations, perhaps for little benefit.

Excise Taxes

- **Proposal:** Excise tax of 1 percent imposed on the investment income of private colleges and universities.
  - Public institutions are exempt from the excise tax.
  - Small private institutions (endowment below $100,000 per student) are exempt.
  - *Score:* Gain of $1.7 billion.
  - *Comments:*
    - The proposal likely arises from long-standing concerns about the accumulation of funds at private universities, though the precise rationale for the tax is unclear.
    - The tax is a flat tax on accumulated income of educational institutions. There is no way to avoid paying the tax (i.e., through a payout).
    - The proposal uses the private foundation investment income tax as the base, thus in effect extending a tax with an imperfect rationale to a subset of public charities.
    - As with extending the investment income tax to private operating foundations, the proposal raises the question whether a broader examination of the exemption for investment income for other EOs, including noncharitable exempts, is warranted.

Excise Taxes

- **Proposal:** Excise tax on excess executive compensation.
  - In general, the proposal imposes a tax of 25 percent of the excess over $1 million (generally in wages) paid to a “covered employee,” which includes the top five compensated employees of an organization. Organizations subject to the tax include all § 501 exempt organizations, farmers’ co-ops, and some government entities.
  - The excise tax also applies separately to “excess parachute payments.”
  - *Score:* Gain of $500 million.
  - *Comments:*
    - The proposal apparently reflects a similar proposal applicable to taxable organizations. Some parallel with for-profit compensation is important, as otherwise the proposal could lead some exempts (perhaps especially hospitals) to convert to for-profit status.
    - The proposal seems arbitrary and does not take into account the services provided by the employee or the market demand for services.
    - The proposal is irrational in applying only to the top five compensated employees. If the policy of the proposal is to set a bright line on unreasonable compensation, then it should apply to all employees paid over the threshold.
    - Although some abuses might be curbed, the cost of hiring talent would increase.
    - There is a question of how the proposal would interact with the excise tax on intermediate sanctions (§ 4958) and self-dealing (§ 4941), both of which penalize excess compensation.

Supporting Organizations

- **Proposal:** Repeal the Type II and Type III public charity category of supporting organization.
  - Effective for existing organizations for taxable years beginning after December 31, 2015.
  - *Score:* Gain of $1.4 billion.
  - *Comments:*
    - Affected supported organizations would have to become either private foundations or change their charter to be controlled by the publicly supported charity (i.e., become a Type I supporting organization).
    - The IRS would have to provide some process for conversion.
      - Conversion to a Type I supporting organization would be difficult for Type III supporting organizations that support multiple charities.
    - Type III supporting organizations in particular have been a source of abuse. Abuses at Type II supporting organizations are less well-known.
    - The proposal would simplify the Code. Current supporting organization rules are very complex and present considerable compliance and administrative challenges.
    - Type II and Type III supporting organizations offer flexibility and are not inherently abusive. Supporting organizations have been used to house the endowments of state universities and to act as a parent entity of hospital systems.
    - On the other hand, the proposal may reflect a judgment that despite the flexibility offered by supporting organizations, the legal regime has become too remote from original congressional intent, complex to administer, and prone to abuse.

501(c)(6)

- **Proposal:** Repeal the tax-exempt status for professional sports leagues organized under § 501(c)(6).
  - The proposal would affect, for example, the NFL and PGA.
  - The proposal does not affect trade associations more generally.
  - *Score:* Gain of $100 million.
  - *Comments:*
    - In general, the tax benefit provided by 501(c)(6) is deferral of deductions (members deduct contributions currently instead of when amounts are spent) and conversion of capital expenditures to current deductions. Revocation of exemption reflects a policy judgment that these benefits are not warranted for the groups affected.
    - Another approach would be to tax the investment income of professional sports leagues as well as other 501(c)(6)s and 501(c)s.

501(c)(15), 501(c)(29)

- **Proposal:** Repeal of exemption from tax for small casualty insurance companies (501(c)(15)) and CO-OP health insurance issuers (501(c)(29)).
  - *Score:* Gain of $700 million.
  - No comment.

501(c)(27)

- **Proposal:** Limits exempt status under 501(c)(27) to organizations that offer only workers compensation insurance to in-state employers.
  - *Score:* Gain of less than $50 million.
  - No comment.

Administrative Provisions

- **Proposal:** Require 501(c)(4) organizations to notify IRS of intent to operate.
  - Notice must be provided within 60 days of operation and acknowledged by the IRS within 60 days of receipt. The notice and acknowledgement would be publicly available. A user fee is imposed (to be determined by the IRS).
  - The notice would provide name, address, and purpose of the organization; date and place of formation; and EIN.
  - There is a penalty of $20/day up to a $5,000 cap for failure to file the notice (imposed on the organization) and for failure to respond to an IRS demand to file (imposed on the manager).
  - An organization may still apply for a determination of 501(c)(4) status, but on a form other than current Form 1024.
  - *Score:* Gain of less than $50 million.
  - *Comments:*
    - If the proposal is directed toward the use of 501(c)(4) organizations for political activity, it seems both over- and under-inclusive. Some 501(c)(4)s do not engage in political activity, so the change would seem unwarranted for them. Further, to the extent the proposal reflects concern about the political activities of noncharitable exempts before the filing of the Form 990, the notice requirement is under-inclusive: it could be extended to other 501(c) organizations.
    - The purpose of the proposal is not evident. It is unclear what the IRS (or the public) would do with the information. A return (not just a notice) generally is required for an audit. The information provided on the notice also is generic and would not alert the IRS to any particular activity worthy of attention.
    - The proposal adds administrative burdens on the IRS.
    - The proposal likely will lead to many uncollected penalties, as many small organizations will simply fail to comply through ignorance (similar to the automatic revocation nonfilings). This would further erode confidence in the IRS and undermine the rule of law.

Administrative Provisions

- **Proposal:** Allow 501(c)(4)s to obtain a declaratory judgment relating to IRS determinations of exempt status.
  - The proposal extends current law declaratory judgment procedures available for 501(c)(3) organizations (i.e., § 7428) to 501(c)(4) organizations.
  - *Score:* Loss of less than $50 million.
  - *Comments:*
    - Revives a proposal that has long been part of "good government" bills but never enacted.
    - In general, the proposal dilutes IRS authority to determine the scope of exemption under section 501(c)(4), likely leading to an expansion of the category through successful court challenges to adverse determinations.
    - Proposal might result in speedier determinations of exempt status, as the IRS must act within 270 days of status application or else a declaratory judgment is available.

Administrative Provisions

- **Proposal:** Limit the disclosure of donors by 501(c)(4)s to the IRS on the Form 990.
  - Proposal requires that 501(c)(4) organizations disclose to the IRS only contributions over $5,000 by an officer, director, or top-five compensated employee.
  - *Score:* Loss of less than $50 million.
  - *Comments:*
    - Donor information can be relevant to the IRS in making exempt status and intermediate sanctions determinations, thus the proposal weakens these provisions by limiting IRS knowledge.
    - To the extent the proposal is directed to concerns about targeting of political activity, it is both overbroad in applying to all 501(c)(4) organizations (many of which do not engage in political activity), and under-inclusive in not applying to other 501(c) groups that do engage in political activity.
    - The proposal furthers the divide between section 527 political organizations and 501(c)(4) organizations, as 527s have to disclose donors to the IRS and make donor information public.

Administrative Provisions

- **Proposal**: Mandatory e-filing of Form 990 series returns.
  - IRS is required to make Form 990 information publicly available in a machine-readable format as soon as practicable.
  - The proposal is effective for taxable years beginning after the date of enactment, with transition relief for small organizations.
  - The IRS may delay the effective date two years for Form 990-T (UBIT) and 6033(e) filings.
  - *Score:* No revenue effect.
  - *Comment:* E-filing generally should foster compliance, but the IRS must be able to implement electronic filing.

Conclusion

- The Camp draft is an important contribution to the debate of how best to reform the exempt organization tax provisions. In general, certain reform themes and conclusions emerge from the Camp draft:
  - The charitable deduction is supported by a base-defining theory. Charitable contributions are better accounted for by an increase to the standard deduction than with an itemized deduction; however, some role for the subsidy of charitable contributions remains.
  - Unrelated businesses of exempt organizations generally should be discouraged and the exemption for passive income narrowed.
  - Compliance by exempt organizations is problematic. The IRS needs additional enforcement tools, through increased filing penalties, strengthening intermediate sanctions, and the imposition of new excise taxes.
  - The law is too complex, and it should be simplified through the elimination of some tax classifications and rules.
  - The tax rules are too generous to charitable organizations that accumulate funds, including donor-advised funds, private operating foundations, and colleges and universities.