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Nonprofits and the Tax Reform Act of 2014: What Board Members and Executive Directors Need to Know!

Presented by

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I. Introduction

There has been much talk about federal tax reform in recent years. The fervor increased after the 2014 election, as some view tax reform as one of only a few significant legislative initiatives in which Congress and the President share common ground. To date, the most concrete step toward reforming the current Internal Revenue Code (the "Code") has been the February 2014 release of a discussion draft "Tax Reform Act of 2014" prepared by the Chairman of the House Committee on Ways and Means (the "Bill").[1] **The Bill has not been enacted into law, and it is unlikely that any forthcoming tax reform law would implement the Bill's provisions exactly as described in this outline, the accompanying teleconference, and the attached materials.** However, it is useful for nonprofit officials and their advisors to examine the provisions of the Bill, so they can knowledgably advocate for or against provisions affecting their organization and can prepare as appropriate for possible changes in the law.

II. Detailed descriptions of the Bill's provisions

a. The nonpartisan Joint Committee on Taxation released a multi-part *Technical Explanation of the Tax Reform Act of 2014, A Discussion Draft of the Chairman of the House Committee on Ways and Means to Reform the Internal Revenue Code*, which is available at http://tax.house.gov using the "JCT Materials" link.

b. Also released in connection with the Bill were a Press Release, an Executive Summary, and a Section-By-Section Summary prepared by Ways and Means Committee Majority Tax Staff. All are available at http://tax.house.gov.

III. Caveats

a. This outline and the related presentation do not address the following:

   i. Provisions in the Bill that would apply to other taxpayers (e.g., for-profit corporations or individuals) as well as tax-exempt organizations.

[1] The discussion draft Bill is available at http://tax.house.gov using the "Draft Legislation" link. This outline relates to version Camp_041.XML. Most of the provisions that would directly affect tax exempt entities are in Title V of the Act.

Examples include changes in the corporate income tax rates, which would affect exempt organizations that pay unrelated business income tax.

ii. The potential indirect effects that certain provisions of the Bill might have on tax-exempt organizations. One example of such indirect effects is the increase in charitable giving that might result from the Bill's projected decrease in federal income tax imposed on the average individual taxpayer.

iii. The provisions discussed in this outline have been selected based on the expected interests of the audience. Not all provisions relevant to tax-exempt organizations are discussed herein, such as, for example, certain provisions related to charitable trusts.

IV. Charitable contributions (Bill sec. 1403 and Code sec. 170).

a. Two-percent floor on charitable deduction for individuals. The Bill would impose a 2-percent floor on charitable contributions by taxpayers who are individuals. That is, the amount of an individual's charitable contributions for a taxable year (determined without regard to excess contributions carried over from a prior year) would be reduced by 2 percent of the taxpayer's contribution base (in most cases, AGI) for the taxable year. This proposal, combined with a higher standard deduction (described below) that would drastically reduce the number of taxpayers who choose to itemize, would eliminate the tax incentive for charitable giving by certain donors.

b. Standard deduction (Bill sec. 1101 and Code sec. 63 of the Code). Under present law, a taxpayer may reduce his adjusted gross income by the amount of the applicable standard deduction. For 2014, the amount of the standard deduction is $6,200 for single individuals and married individuals filing separate returns, $9,100 for heads of households, and $12,400 for married individuals filing a joint return and surviving spouses. The Bill would increase the standard deduction for taxpayers across all filing statuses: to $22,000 for married individuals filing a joint return and $11,000 for all other taxpayers, indexed for inflation.

c. <u>Extension of time for individuals to make charitable contributions</u>. Under current law, individuals may only deduct charitable contributions for the taxable year in which the contribution is made. The Bill would permit individuals to elect to deduct for a taxable year charitable contributions made after the close of the taxable year but not later than the due date (determined without regard to extensions) for the individual's income tax return for the taxable year.

d. <u>Deduction for contributions of appreciated property generally limited to basis</u>. Under current law, a taxpayer generally may deduct the full fair market value of long-term capital gain property contributed to charity. Subject to significant exceptions, contributions of tangible personal property are also generally deductible at fair market value if the use by the recipient charitable organization is related to its tax-exempt purpose. The Bill would generally limit a charitable contribution of appreciated property to the taxpayer's basis in the property. However, contributions of certain property would be deductible to the extent of gain that would have been long-term capital gain if the property contributed had been sold by the taxpayer at its fair market (determined at the time of the contribution). These contributions include:

   i. Contributions of tangible personal property if the use of the property by the donee organization is related to the purpose or function constituting the basis for its exemption,
   ii. Qualified conservation contributions,
   iii. Contributions of inventory and similar property that qualify for an enhanced charitable contribution deduction under present law,
   iv. Contributions of scientific property used for research that qualify for an enhanced deduction under present law, and
   v. Certain contributions of qualified appreciated stock.

e. <u>Modifications to income-based percentage limits and repeal of separate, lower percentage limits for contributions of capital gain property</u>. The Bill would reduce from 50 percent to 40 percent the income-based percentage limit described in section for certain charitable contributions by an individual taxpayer of cash and property that is not appreciated to public charities and certain other

organizations. The Bill would reduce the percentage limit for certain charitable contributions by an individual taxpayer to nonoperating private foundations from 30 percent to 25 percent. The Bill would repeal the provisions that provide lower percentage limitations on contributions of capital gain property, which generally impose a 30-percent limit on charitable contributions of capital gain property to public charities and certain other organizations and a 20-percent limit on charitable contributions of capital gain property to nonoperating private foundations and certain other organizations.

f. Qualified conservation contributions. The Bill would extend and make permanent the special rules for qualified conservation contributions that provide for increased charitable contribution percentage limits and extended carryforward periods for excess contributions.

g. Golf course easements. The Bill would modify the definition of a qualified real property interest that may be treated as a qualified conservation contribution generally to exclude property that is, or is intended to be, used as a golf course.

h. College athletic event seating rights. The Bill would repeal current law that generally allows a taxpayer to deduct 80 percent of certain payments to institutions of higher education in exchange for the right to purchase tickets or seating at an athletic event of such an institution.

i. Contributions of intellectual property. The Bill would repeal current law under which certain donee income from intellectual property is treated as an additional charitable contribution.

j. Repeal of overall limitation on itemized deductions (Bill sec. 1415 and Code sec. 68). The Bill would repeal the current law's so-called Pease Amendment, which reduces the total amount of otherwise allowable itemized deductions by 3 percent of the amount by which AGI exceeds a certain threshold for certain high-income tax payers.

k. IRA charitable rollover. The Bill would not include the IRA charitable rollover provision, which was recently revived to cover rollovers in 2014 along with other "tax extenders" provisions.

V. Unrelated Business Income Tax provisions.

a. Background. Code section 501(a) exempts certain organizations from federal income tax, including organizations described in section 501(c) (e.g., 501(c)(3) charities and section 501(c)(4) social welfare organizations) and pension, profit-sharing, and stock bonus plans described in section 401(a). Despite being "tax exempt," these nonprofits are subject to a number of taxes, including wage taxes, sales and use tax, property tax, and the unrelated business income tax ("UBIT").[2]

b. UBIT overview. Notwithstanding the general exemption from federal corporate income tax, most exempt organizations, including those exempt under IRC § 501(a), are subject to federal corporate income tax on their "unrelated business taxable income" (UBTI). See IRC § 511(a).

   i. Congress enacted the UBIT to eliminate perceived unfair competition by taxing the unrelated business activities of tax-exempt organizations in the same manner as the for-profit businesses with which they compete. The UBIT rules impose corporate tax on the net profits an exempt organization derives from the conduct of certain business activities that do not further the organization's exempt purposes (other than through the production of funds).

   ii. UBTI generally includes "the gross income derived by any organization from any unrelated trade or business … regularly carried on by it," less allowed deductions and subject to certain exclusions. IRC § 512(a). Unless an exception applies, gross income of an exempt organization is includible in the computation of UBIT if:

      a. It is income from trade or business;
      b. such trade or business is regularly carried on by the organization; and
      c. the conduct of such trade or business is not substantially related (other than through the production of funds) to the

[2] The term tax-exempt usually refers to exemption from a specific tax or, used generically, to exemption from federal corporate income tax, e.g., under IRC § 501(a).

organization's performance of its exempt functions. Regs. § 1.513-1(a).

iii. There are a number of exclusions from UBIT, including investment income (unless derived from debt-financed property or from certain controlled subsidiaries), income from all-volunteer activities or from the sale of donated goods, and income from certain activities carried on for the convenience of a charity's members, students, patients, officers, or employees, among other exclusions.

iv. One exclusion often relied upon is the exclusion of "qualified sponsorship payments" under Code section 513(i). "Qualified sponsorship payments" generally include any payment made by a person engaged in a trade or business with respect to which the person will receive no substantial return benefit other than the use or acknowledgment of the name or logo (or product lines) of the person's trade or business in connection with the organization's activities.

v. An organization determines its UBTI by subtracting from its gross unrelated business income those deductions that are directly connected with the unrelated trade or business. Under regulations, in determining UBTI, an organization that operates multiple unrelated trades or businesses aggregates income from all such activities and subtracts from the aggregate gross income the aggregate of deductions. As a result, an organization may use a loss from one unrelated trade or business to offset gain from another, thereby reducing total unrelated business taxable income.

vi. UBTI is reported on IRS Form 990-T.

vii. A section 501(c)(3) organization would jeopardize its tax-exempt status by operating an unrelated trade or business as a substantial part of its activities. See Regs. § 1.501(c)(3)-1(e).

viii. Many states also impose corporate income tax on UBTI

c. <u>Bill provisions that would affect nonprofits</u>.

i. Name and logo royalties treated as UBTI (Bill sec. 5002 and Code secs. 512 and 513). Current law treats income from the use of an organization's name or logo as investment income that is exempt from the UBIT. The Bill would generally subject to UBIT any royalty income derived from the licensing of an organization's name or logo. Specifically, the Bill would (a) amend Code section 513 to provide that any sale or licensing by an organization of any name or logo of the organization is treated as an unrelated trade or business that is regularly carried on by the organization and (b) amend section 512 to provide that income derived from any such licensing of a name or logo of the organization is included in the organization's gross UBTI, notwithstanding the provisions of section 512 that otherwise exclude certain types of passive income (including royalties) from unrelated business taxable income.

ii. UBTI separately computed for each trade or business (Bill sec. 5003 and Code sec. 512). The Bill would require an organization with more than one unrelated trade or business to compute its UBTI separately for each trade or business, rather than in the aggregate for all trades or businesses. The organization's UBTI would be the sum of the amounts (but not less than zero) computed for each separate unrelated trade or business, less the "specific deduction" (i.e., annual exclusion, currently $1,000). A net operating loss deduction would be allowed only with respect to a trade or business from which the loss arose and could not offset income from a profitable trade or business. A loss from one taxable year could offset gain from the same unrelated trade or business activity in a different taxable year, where appropriate, and special transition rules would apply.

iii. Exclusion of research income from UBTI limited to publicly available research (Bill sec. 5004 and Code sec. 512(b)(9)). Under current law, if an organization is operated primarily for purposes of carrying on fundamental research the results of which are freely available to the general public, all income derived from research performed by such organization for any person, not just income derived from research

available to the general public, is excluded from UBTI. The Bill would modify that provision to exclude income from such research only if the results of the research are freely available to the general public.

iv. Parity of charitable contribution limitation between trusts and corporations for purposes of computing UBTI (Bill sec. 5005 and Code sec. 512(b)(11)). In computing UBTI under current law, an organization may deduct certain charitable contributions made to other organizations. For most organizations, the charitable contribution deduction is limited to 10 percent of the UBTI (as computed without the charitable deduction). However, the more favorable limits applicable to individuals apply in determining the charitable contribution deduction allowed to charitable trusts described in Code section 511(b). The Bill would apply to such trusts the 10% limit that applies to corporations.

v. Increase in specific deduction against UBTI (Bill sec. 5006 and Code sec. 512(b)(12)). The Bill would increase the specific deduction described in section 512(b)(12), which is essentially an exemption amount, from $1,000 to $10,000.

vi. Repeal of exclusion from UBTI of gain or loss from the disposition of distressed property (Bill sec. 5007 and Code sec. 512(b)(16)). The Bill would repeal the current exclusion from UBTI for income from sales of property held for sale in the ordinary course of a trade or business by excluding gains and losses from the disposition of certain real property and mortgages acquired from financial institutions that are in conservatorship or receivership.

vii. Modify rules concerning qualified sponsorship payments (Bill sec. 5008 and Code sec. 513(i)). The Bill would modify the definition of "qualified sponsorship payment" to exclude from the permitted substantial return benefits the use or acknowledgment of the sponsor's product lines. The Bill would also provide a special rule for any event for which an organization receives total sponsorship payments exceeding $25,000: A payment with respect to such an event would not be a qualified

sponsorship payment unless any use or acknowledgment of the sponsor's name or logo only appeared with, and in substantially the same manner as, the names of a significant portion of the other donors to the organization with respect to such event. Such "significant portion" of donors would be determined by taking into account both the total number of donors to the event and the amounts contributed to the event by such donors, but in no event would fewer than 2 other donors be treated as a significant portion.

VI. Penalties

a. Increase in information return penalties (Bill sec. 5101 and Code sec. 6652(c)).

   i. The Code imposes penalties in the event an exempt organization fails to make certain required disclosures or file required information returns, unless the organization shows that the failure was due to reasonable cause. In certain situations, a penalty may also be imposed on certain individuals who fail to make a filing (i.e., an officer, director, trustee, employee, or other individual who is under a duty to perform the act). The Bill would double the following daily penalty amounts:

      1. Failure to file an annual information return (Code secs. 6652(c)(1)(A) and (B)). The Bill would increase the daily penalty for organizations with gross receipts exceeding $1 million for the year from $100 to $200 and, for smaller organizations, from $20 to $40. The daily penalty on managers who fail to comply with a written demand from the IRS would be increased from $10 to $20.

         a. The maximum penalty with respect to any one return would still be limited to the lesser of $10,000 ($50,000 for organizations with gross receipts exceeding $1 million) or 5% of the organization's gross receipts for the year. The maximum penalty that may be imposed on responsible individuals would remain at $5,000 for any one return.

      2. Failure to make annual returns available for public inspection (Code sec. 6652(c)(1)(C)). The Code generally requires exempt organizations to make their three most recent annual information

returns (990-series forms) and their application for tax exemption. The Bill would increase the daily penalty on any person failing to meet those requirements from $20 to $40. The maximum penalty on all persons for failures with respect to any one return or report would remain at $10,000.

3. Failure to make application for exemption available for public inspection (Code sec. 6652(c)(1)(D)). The Bill would increase the daily penalty on any person failing to meet those requirements from $20 to $40.
4. Liquidating, dissolving, or terminating (Code sec. 6652(c)(2)). The Bill would increase from $10 to $20 the daily penalty on organizations that fail to file a final return, and on responsible persons who fail to comply with a related written demand from the IRS. The maximum penalty per return would remain at $5,000 for the organization and $5,000 for responsible persons.
5. Failure to file a reportable transaction disclosure (Code sec. 6652(c)(3)). The Bill would increase from $100 to $200 the daily penalties on an organization (or, in some cases, a responsible manager) that fails to disclose participation in a prohibited tax shelter transaction. The maximum penalty would remain at $50,000 per return. The daily penalty on the organization or managers who fail to comply with a related written demand from the IRS would also increase from $100 to $200, with the maximum penalty remaining at $10,000 per disclosure.

b. <u>Manager-level accuracy-related penalty on underpayment of UBIT</u> (Bill sec. 5102 and Code secs. 6662 and 6662A). The Code generally imposes an accuracy-related penalty on underpayments of tax attributable to a substantial understatement of income tax (among others). The penalty is 20 percent of the underpayment and can be abated if the taxpayer demonstrates that there was "reasonable cause" for the underpayment and that the taxpayer acted in good faith.

i. The Bill would impose a new penalty on any manager of an organization that made a substantial understatement of income tax attributable to UBIT. This new penalty would equal 5 percent of the underpayment. The term "manager" includes any officer, director, trustee, employee, or other individual who is under a duty to perform an act in respect of which the underpayment occurs. The maximum manager-level penalty imposed with respect to an understatement would be $20,000, and liable managers would have joint and several liability for this penalty.

ii. Tax avoidance transactions. A different accuracy-related penalty applies to understatements stemming from "listed transactions" and other "reportable transactions" with a significant tax avoidance purpose. The Bill would impose a new penalty on any manager of an organization that is subject to the accuracy-related penalty related to reportable transactions. This new penalty would equal 10 percent of the relevant underpayment. For this purpose, the term "manager" includes any officer, director, trustee, employee, or other individual who is under a duty to perform an act in respect of which the underpayment occurs. The maximum manager-level penalty imposed with respect to an understatement would be $40,000, and liable managers would have joint and several liability for this penalty.

VII. Excise Taxes

a. Modification of taxes on excess benefit transactions (intermediate sanctions) (Bill sec. 5201 and Code sec. 4958).

i. Background. The Code imposes excise taxes, often referred to as "intermediate sanctions", on excess benefit transactions between a "disqualified person" and a charitable organization (other than a private foundation) or 501(c)(4) social welfare organization. An excess benefit transaction is generally a transaction in which an economic benefit provided by an organization to a disqualified person exceeds the value of the consideration the organization receives for providing such benefit.

1. Disqualified person. Very generally and subject to special rules, disqualified persons include (1) persons who were, at any time during the five-year period ending on the date of the transaction, in a position to exercise substantial influence over the affairs of the organization (including officers and directors); (2) a member of the family of such a person; and (3) certain 35-percent controlled entities.
2. Excise tax. The excess benefit tax is currently imposed on the disqualified person and, in certain cases, on the organization's managers, but is not imposed on the exempt organization.
    a. On the disqualified person, there is an initial tax of 25 percent of the excess benefit and an additional tax of 200 percent of the excess benefit if the violation is not corrected within the taxable period.
    b. On manager. If such initial 25-percent tax is imposed on a disqualified person, a tax of 10 percent of the excess benefit is imposed on an organization manager who knowingly participated (see below) in the excess benefit transaction, if the manager's participation was willful (see below) and not due to reasonable cause. The maximum manager-level tax under this provision is $20,000 per excess benefit transaction.
    c. If more than one person is liable for the tax on disqualified persons or on management, all such persons are jointly and severally liable for the tax.

ii. <u>Entity-level tax in the event of an excess benefit transaction</u>. The Bill would impose a new excise tax on the organization if an initial excess-benefit tax is imposed on a disqualified person. The new excise tax would be 10 percent of the excess benefit but would not be imposed if the organization: (1) established that the minimum standards of due diligence (described below) were met with respect to the transaction or (2)

established to the satisfaction of the IRS that other reasonable procedures were used to ensure that no excess benefit was provided.

iii. Eliminate rebuttable presumption and establish due diligence procedures. Under current regulations, an exempt organization may avail itself of a rebuttable presumption that a particular compensation arrangement or property transaction is not an excess benefit transaction. Very generally, this requires advance approval by an authorized body, reliance upon data as to comparability, and adequate and concurrent documentation. See Treas. Reg. sec. 53.4958-6. The Bill would eliminate the rebuttable presumption of reasonableness contained in those regulations and would specify that the procedures that presently create a rebuttable presumption of reasonableness would instead establish that an organization has performed the minimum standards of due diligence with respect to an arrangement or transfer involving a disqualified person. Satisfaction of these minimum standards would not result in a presumption of reasonableness with respect to the transaction but would avoid the proposed excess-benefit tax on the organization described immediately above (but not the excess-benefit taxes on the disqualified person and liable managers).

iv. Eliminate certain special rules for knowing behavior by organization managers. For purposes of determining manager liability for excess-benefit tax under current regulations, a manager's participation in an excess benefit transaction ordinarily is not considered knowing if, after full disclosure of the factual situation to an appropriate professional, the organization manager relies on a reasoned written opinion of that professional with respect to elements of the transaction within the professional's expertise. The Bill would eliminate that rule. (However, a manager's reliance on professional advice would remain relevant in determining whether the manager knowingly participated in an excess benefit transaction.) The Bill would also eliminate the regulatory rule that provides that an organization manager ordinarily does not act knowingly

for purposes of the excess benefit transaction excise tax if the organization has met the requirements of the rebuttable presumption procedure.

v. Treat investment advisors and athletic coaches as disqualified persons. The Bill would modify the definition of a disqualified person for purposes of the intermediate sanctions rules to include (a) persons who performs services as an athletic coach for the organization and (b) investment advisors, under the rules currently applicable to donor advised funds but with a narrower definition of investment advisor.

vi. Application of intermediate sanctions rules to section 501(c)(5) and section 501(c)(6) organizations. The Bill would extend application of the excess benefit transaction rules to tax-exempt organizations described in Code sections 501(c)(5) (labor and certain other organizations) and 501(c)(6) (business leagues and certain other organizations).

b. Modification of taxes on self-dealing (Bill sec. 5202 and Code sec. 4941).

i. Background. The Code imposes excise taxes on acts of self-dealing between a disqualified person (described above) and a private foundation. In general, self-dealing transactions are any direct or indirect (1) sale, exchange, or leasing of property between a private foundation and a disqualified person, (2) lending of money or other extension of credit between a private foundation and a disqualified person, except for no-interest loans by a disqualified person, the proceeds of which are used exclusively for charitable purposes; (3) the furnishing of goods, services, or facilities between a private foundation and a disqualified person, unless the goods, services, or facilities are (i) functionally related to the foundation's exempt purposes and are provided to or by the foundation on the same basis as provided by the foundation or disqualified person to the general public, (ii) reasonable and necessary to performing exempt purposes and not excessive, or (iii) provided by disqualified person without charge; (4) the transfer to, or use by or for the benefit of, a disqualified person of the income or assets of the private foundation,

unless the use or benefit is de minimis; and (5) certain payments of money or property to a government official.

1. Excise tax. The self-dealing tax is currently imposed on the disqualified person and, in certain cases, on the organization's managers, but is not imposed on the exempt organization.
    a. Initial tax on disqualified person. An initial tax of 10 percent of the amount involved with respect to an act of self-dealing is imposed on any disqualified person (other than a foundation manager acting only as such) who participates in the act of self-dealing.
    b. Initial tax on manager. If such initial tax is imposed on a disqualified person, a tax of 5 percent of the amount involved is imposed on a foundation manager who knowingly participated (see below) in the excess benefit transaction, if the manager's participation was willful (see below) and not due to reasonable cause. The maximum manager-level tax under this provision is $20,000 per act.
    c. Such initial taxes are imposed for each year (or part thereof) during the "taxable period", i.e., the period that begins when the act of self-dealing occurs and ends on the earliest of (x) the date of mailing of a notice of deficiency for the tax, (y) the date on which the tax is assessed, or (z) the date on which correction of the act of self-dealing is completed.
    d. Additional tax. If the act of self-dealing is not corrected, a tax of 200 percent of the amount involved is imposed on the disqualified person, and a tax of 50 percent of the amount involved (up to $20,000 per act) is imposed on a foundation manager who refused to agree to correcting the act of self-dealing.

e. If more than one person is liable for the tax on disqualified persons or on foundation managers, all such persons are jointly and severally liable for the tax.

ii. Entity level tax on private foundations. The Bill would impose a new excise tax on the foundation if an initial self-dealing tax is imposed on a disqualified person. The new excise tax would be 2.5 percent (10 percent in the case of a payment of compensation) of the amount involved with respect to the act of self-dealing for each year (or part thereof) in the taxable period (as defined above).

iii. Eliminate special rule for knowing behavior by foundation managers. For purposes of determining manager liability for self-dealing tax under current regulations, a manager's participation in a self-dealing transaction ordinarily is not considered knowing if, after full disclosure of the factual situation to legal counsel, the manager relies on a reasoned written legal opinion that an act is not an act of self-dealing. The Bill would eliminate that rule. (However, a foundation manager's reliance on legal advice would remain relevant in determining whether the manager knowingly participated in a self-dealing transaction.)

c. Excise tax on failure to distribute within five years a contribution to a donor advised fund (Bill sec. 5203 and proposed new Code sec. 4968). The Bill would generally require that contributions to donor advised funds be distributed for charitable purposes within a specified time period and would impose an excise tax on the sponsoring organization for failure to make the required distribution. The tax would equal 20 percent of so much of a contribution as has not been distributed by the sponsoring organization in an eligible distribution (generally, to a public charity other than a supporting organization or another donor advised fund) before the beginning of the sixth (or any succeeding) taxable year beginning after the taxable year during which such contribution is made. Distributions would be treated as made from contributions (and any earnings attributable thereto) on a first-in, first-out basis.

d. Simplification of excise tax on private foundation investment income (Bill sec. 5204 and Code sec. 4940). The Code imposes a 2-percent excise tax on the net investment income of private foundations that are exempt from tax under section 501(a). The rate is generally reduced to 1 percent in any year in which a foundation's qualifying distributions exceed the average historical level of its qualifying distributions. The Bill would replace the two rates of excise tax on tax-exempt private foundations with a single rate of tax of 1 percent on net investment income. The Bill would also repeal the exception for operating foundations from the tax on net investment income.

e. Repeal of exception for private operating foundation failure to distribute income (Bill sec. 5205 and Code sec. 4942). The Code imposes a two-tiered excise tax on private foundations, other than operating foundations, that do not distribute a minimum amount each year as qualifying distributions. In general, a qualifying distribution is an amount paid to accomplish one or more of the organization's exempt purposes, including reasonable and necessary administrative expenses. The Bill would repeal the exception for private operating foundations from this excise tax, thereby extending the excise tax to private operating foundations.

f. Excise tax based on investment income of private colleges and universities (Bill sec. 5206 and proposed new Code sec. 4969). The Bill would impose an excise tax on an applicable educational institution equal to 1 percent of its net investment income for the taxable year. Net investment income would be determined under rules similar to those defining the net investment income of a private foundation. This new tax would generally apply to private colleges and universities having assets (other than those assets used directly in carrying out the institution's exempt purpose) with an aggregate fair market value of at least $100,000 per student.

g. Repeal of tax-exempt status for professional sports leagues (Bill sec. 5301 and Code sec. 501(c)(6)). The Bill would repeal the current tax exemption of professional sports leagues under Code section 501(c)(6).

h. Repeal of exemption from tax for certain insurance companies and CO-OP health insurance issuers (Bill sec. 5302 and Code sec. 501). The Bill would repeal the

exemptions under section 501(c)(15) (certain stock property and casualty insurance companies and certain mutual property and casualty insurance companies) and section 501(c)(29 (qualified nonprofit health insurance issuers that have received a loan or grant under the Patient Protection and Affordable Care Act). Transition relief provisions would apply to organizations in existence prior to the effective date.

i. In-State requirement for certain tax-exempt workmen's compensation insurance organizations (Bill sec. 5303 and Code sec. 501(c)(27)). The Bill would amend section 501(c)(27)(B) to limit tax-exempt status under that subparagraph to organizations that offer no insurance other than workmen's compensation insurance offered to any employer in the State (for employees in the State or temporarily assigned out-of-State).

j. Repeal of Type II and Type III supporting organizations (Bill sec. 5304 and Code sec. 509(a)(3)). The Bill would repeal public charity status for Type II and Type III supporting organizations. Thus, an organization would no longer satisfy the relationship test by being supervised or controlled in connection with one or more publicly supported organizations (Type II supporting organizations) or by being operated in connection with one or more publicly supported organizations (Type III supporting organizations). A delayed effective date of December 31, 2015, would apply for Type II and Type III supporting organizations recognized as such as of the date of the Bill's enactment.

VIII. IRS Investigation-Related Reforms

a. Require section 501(c)(4) organizations to provide notice of formation (Bill sec. 6001 and proposed new Code sec. 506). Under current law, most types of section 501(c) organizations, including organizations described within sections 501(c)(4) (social welfare organizations), are tax exempt if they satisfy the relevant requirements and are not required to obtain IRS recognition of exempt status.

    i. Notice requirement. The Bill would require 501(c)(4) organizations to notify the IRS of its formation and intent to operate as a 501(c)(4) organization no later than 60 days following the organization's

establishment , which can be extended for reasonable cause. The notice must include (1) the name, address, and taxpayer identification number of the organization; (2) the date on which, and the State under the laws of which, the organization was organized; and (3) a statement of the purpose of the organization. The IRS would have 60 days to acknowledge such notice. Public disclosure of the notice and receipt would be required.

ii. Penalties. Failure to file such notice would subject the organization to a daily penalty of $20, up to a maximum of $5,000. If such a penalty is imposed, the IRS may make a written demand on the organization specifying a date by which the notice must be provided. If any person fails to comply with such a demand, a penalty of $20 is imposed for each day the failure continues, up to a maximum of $5,000.

iii. Expanded reporting on first information return. With its first annual information return (Form 990, 990-EZ, or 990-N), a section 501(c)(4) organization would be required to provide such information supporting its qualification under section 501(c)(4). The IRS would not be required to issue a determination letter following the organization's filing of the expanded first annual information return.

iv. Application for IRS recognition. An organization that desired IRS recognition of its qualification under section 501(c)(4) could request such a determination from the IRS. Such a request would be in addition to the required notice and expanded first-year 990 reporting described above. It is intended that such a request for a determination would be submitted on a new form (separate from Form 1024, which may continue to be used by certain other organizations) that clearly states that filing such a request is optional.

v. Transition provision. Organizations formed prior to the effective date, that have not filed an application for exemption (Form 1024) or annual information return by date of enactment, would be required to provide the required notice within 180 days of the date of enactment.

b. Declaratory judgment procedure for organizations exempt from tax under section 501(c)(4) (Bill sec. 6002 and Code sec. 7428). The Bill would extend the declaratory judgment procedure to the initial determination or continuing classification of an organization as tax-exempt as a 501(c)(4) organization.

c. Modify reporting requirements for contributions to social welfare organizations (Bill sec. 6003 and Code sec. 6033 of the Code). The Bill would limit the contributor information that a 501(c)(4) organization must report on its annual information return. Information could only be required to the extent a contribution or gift exceeded $5,000 and was made by an officer or director of the organization (or a person having powers or responsibilities similar to those of an officer or director) or by a covered employee. For this purpose, covered employee means a person who was (1) one of the five highest compensated employees of the organization for the taxable year, or (2) was a covered employee of the organization (or any predecessor organization) for any preceding taxable year beginning after December 31, 2013.

IX. Miscellaneous Provisions

a. Applicable standard for determining whether an organization is operated exclusively for the promotion of social welfare (Bill sec. 6011). There has been much discussion regarding political activity by 501(c)(4) organizations, and the IRS released (but is now revising) proposed regulations intended to clarify the limits of such activity. Under the Bill, the standards and definitions used to determine whether an organization is operated exclusively for the promotion of social welfare for purposes of section 501(c)(4), would be as in effect on January 1, 2010. The Bill would also provide that neither the Secretary nor any delegate of the Secretary could issue, revise, or finalize any regulation, revenue ruling, or other guidance relating to such standards or definitions, except for guidance issued only to a particular taxpayer. These provisions would apply for a one-year period beginning on the date of enactment.

b. Termination of private activity bonds (Bill sec. 3431 and Code sec. 103). The Bill would repeal a long-standing Code provision that provides exclusion from

gross income for interest paid on qualified private activity bonds, including bonds issued on behalf of 501(c)(3) organizations. Thus, interest on any private activity bond issued after the effective date would be includible in the gross income of the taxpayer receiving such interest.

c. Mandatory e-filing by exempt organizations (Bill sec. 6004 and Code sec. 6033). The Bill would the requirement to e-file to all tax-exempt organizations required to file statements or returns in the Form 990 series. The proposal would also require the IRS to make the information provided on the forms available to the public in a machine-readable format as soon as practicable. The e-filing requirement would generally be effective for taxable years beginning after date of enactment.

    i. Transition relief. For certain small organizations (and other organizations the IRS determines would suffer undue hardship in the absence of additional transitional time), the e-filing requirement could be delayed by up to 2 years. For this purpose, small organization means organization: (1) the gross receipts of which for the taxable year are less than $200,000; and (2) the aggregate gross assets of which at the end of the taxable year are less than $500,000. For e-filing of Form 990-T, the Bill would give the IRS discretion to delay the effective date by up to 2 years.

d. Excise tax on excess tax-exempt organization executive compensation (Bill sec. 3803 and proposed new Code sec. 4960). The Bill would impose on tax-exempt employers a new excise tax of 25 percent of the sum of the (1) remuneration (other than an excess parachute payment) in excess of $1 million paid to a covered employee by an applicable tax-exempt organization for a taxable year, and (2) any excess parachute payment paid by the applicable tax-exempt organization to a covered employee. The excise tax could apply to an excess parachute payment, even if the covered employee's remuneration did not exceed $1 million. For purposes of the proposal, a "covered employee" is an employee (including any former employee) who is one of the five highest compensated employees of the organization for the taxable year or was a covered employee of the organization (or a predecessor) for any preceding taxable year beginning after

December 31, 2013. The term "applicable tax-exempt organization" includes all organizations exempt from tax under Code section 501(a) (including 501(c) organizations), among others. "Remuneration" is defined in the Bill and would include remuneration paid by certain related entities.