

## Recent Joint Committee on Taxation Proposals Affecting Exempt Organizations

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On January 27, the Joint Committee on Taxation (“JCT”) released a 430-page report describing proposals to curtail tax shelters, close loopholes, and address other areas of noncompliance. The report, “Options to Improve Tax Compliance and Reform Tax Expenditures,” was requested by Senate Finance Committee Chair Charles Grassley and ranking Democrat Max Baucus to identify ways to reduce the size of the “tax gap,” which is the difference between how much taxpayers collectively owe and how much is actually collected. The report contains 72 proposals in various areas of tax law and 12 specifically for exempt organizations, including the following:

1. **Require a five-year review of exempt status of public charities and private foundations and annual notice by organizations not required to file information returns.**
  - This proposal would require that every five years Section 501(c)(3) organizations (except churches, synagogues, mosques, and certain other religious organizations) file information that would enable the IRS to determine whether the organization continues to operate for exempt purposes and whether its original determination letter should remain in effect. Failure to file would result in loss of tax-exempt status.
  - The proposal would also require organizations that are not required to file Form 990 because their gross receipts are under \$25,000 to file an annual notice with the IRS containing basic information on the organization. The annual notice requirement would not extend to churches and other religious organizations not required to file Form 990.
  - Finally, the proposal provides that an organization that fails to file the proposed annual notice or an annual information return for three consecutive years would have its tax-exempt status automatically revoked and would have no right to challenge the revocation.
2. **Impose termination tax on conversions of assets of charitable organizations.**
  - In an effort to address concerns regarding the sale or transfer of assets of charitable organizations to for-profit entities, the proposal would extend a modified version of the current Section 507 termination tax applicable to private foundations to conversions and liquidations of public charities and private foundations, including the transfer of assets from a charity to an organization that is exempt other than as a charity (e.g., a Section 501(c)(4) social welfare organization). An organization would be subject to tax equal to the value of the organization’s net assets that are not dedicated to charitable purposes following the transaction.
  - To ensure that the acquiring entity paid fair value in a conversion transaction, the proposal would extend the intermediate sanctions rules (for public charities) and the self-dealing rules (for private foundations) to the acquirer of the charitable organization’s assets (other than

charities or governmental entities), if persons who are disqualified persons with respect to the charitable organization are in a position to exercise substantial influence over the affairs of the acquiring organization at the time of the transaction or for five years thereafter.

- The proposal would also require charitable organizations to notify the IRS at various stages of a conversion or liquidation in order to provide the IRS with an opportunity to review the proposed transaction.

**3. Tax involvement by exempt organizations in tax-shelter transactions .**

- The proposal requires disclosure by exempt organizations to the IRS of participation in certain tax-shelter transactions that have been identified by the IRS and disclosure of other parties in the transaction.
- The proposal would impose new penalties on both the exempt organization and on organization managers for participation in prohibited tax shelter transactions.

**4. Reform intermediate sanctions and extend certain reforms to private foundations .**

- The proposal would eliminate the current rebuttable presumption of reasonableness under the intermediate sanctions rules, compliance with which shifts the burden of proof from the taxpayer to the IRS in the event of a challenge to the reasonableness of a particular transaction with a disqualified person. Instead, under the proposal, the procedures that presently provide an organization with a presumption of reasonableness (i.e., advance approval by an independent board or committee, reliance upon data as to comparability, and adequate and contemporaneous documentation) generally will establish that an organization has performed the minimum standards of due diligence with respect to the transaction. Satisfaction of these minimum standards would not result in any presumption of any sort.
- The proposal would also extend the minimum standards of due diligence to transactions between private foundations and disqualified persons for purposes of the self-dealing rules.
- The proposal would eliminate the special rules providing that an organization manager or foundation manager's participation is not "knowing" for purposes of the intermediate sanctions rules and self-dealing rules if the manager relied on professional advice. The proposal would also eliminate the special rule under intermediate sanctions that provides that an organization manager does not act knowingly if the organization met the requirements of the rebuttable presumption procedure.
- Under the proposal, the initial contract exception would be modified to provide that an initial contract between a person who was not a disqualified person prior to entering into the contract is subject to intermediate sanctions rules if the person would become a disqualified person upon (1) entering into the contract, or (2) under the terms of the contract, at any time within two years of the time the contract is entered into.
- Finally, the proposal would impose an entity-level tax on public charities and Section 501(c)(4) social welfare organizations (10% of the excess benefit) and on private foundations (2.5% of the amount involved), if an initial tax is imposed on a disqualified person under the intermediate sanctions rules or the self-dealing rules. No tax would be imposed on the organization if it established that it had operated consistent with the minimum standards of due diligence (see above) with respect to the transaction at issue.

**5. Increase the amount of excise taxes imposed on public charities, social welfare organizations, and private foundations.**

- For acts of self-dealing other than payment of compensation by a private foundation to a disqualified person, the initial tax on the self-dealer would be increased from 5% to 10% of the amount involved.
- For acts of self-dealing involving the payment of compensation by a private foundation to a disqualified person, the initial tax on the self-dealer would be increased from 5% to 25% of the amount involved, 15% of which is subject to abatement.
- The initial tax on foundation managers would be increased from 2.5% to 5% of the amount involved and the dollar limitation on the amount of the initial and additional taxes on foundation managers per act of self-dealing would increase from \$10,000 per act to \$20,000 per act.
- The proposal would double the dollar limitation on organization managers of public charities and social welfare organizations for participation in excess benefit transactions from \$10,000 per transaction to \$20,000 per transaction.
- The proposal also would double the amount of the initial taxes and the dollar limitations on foundation managers with respect to the private foundation excise taxes on failure to distribute income (Section 4942), excess business holdings (Section 4943), jeopardizing investments (Section 4944), and taxable expenditures (Section 4945).

#### 6. **Reform rules for charitable contributions of property.**

- This proposal includes two primary options designed to eliminate the value-based deduction for certain charitable contributions of property, and includes a discussion of several other approaches to addressing concerns regarding property contributions.
- The proposal's Option 1 would provide that the deduction for contributions of property is the lesser of basis or fair market value, except for contributions of publicly traded securities, which would still be eligible for a fair market value deduction.
- Option 2 is similar to Option 1, but would retain a fair market value deduction for contributions of property to be used to substantially further the exempt purposes of the recipient organization. Option 2 includes a recapture tax if exempt use property is disposed of by the recipient organization within three years of the contribution date.
- The proposal also includes suggestions for enhanced appraiser accountability rules, limiting a donor's deduction for nonexempt use property to the disposition amount, and eliminating, in whole or in part, the charitable contribution deduction for in-kind property.

#### 7. **Require public disclosure of Form 990-T and related certification requirements.**

- This proposal would extend the present public inspection and disclosure requirements and penalties applicable to Form 990 to Form 990-T.
- The proposal also would require organizations that normally have annual total gross revenues or gross assets of at least \$10 million to include with Form 990 and 990-T filings a certification by an independent auditor or independent counsel that the organization's filings accurately reflect the organization's unrelated business income tax liability.

There are several additional proposals affecting exempt organizations in the JCT report including proposals to (1) modify the charitable deduction for contributions of conservation and façade easements; (2) limit the charitable deduction for contributions of clothing and household items; (3) amend the definition of gross investment income to include income from notional principal contracts, annuities, and "other substantially similar income from ordinary and routine investments" for purposes of the tax on private foundation net investment income; (4) limit the tax-exempt status of

fraternal benefit societies that provide commercial-type insurance; and (5) establish additional exemption standards for credit counseling organizations. There are also several proposals intended to address perceived abuses of tax-exempt bonds.

While the JCT report contains dozens of proposals not directed at exempt organizations, Senator Grassley singled out and praised the report's discussion of possible changes in the law governing exempt organizations and charitable donations. There is speculation that the Senate Finance Committee and possibly the Ways and Means Committee will hold hearings this year to continue the push for reform in the nonprofit sector initiated primarily by the Finance Committee last year. Assuming such hearings occur, it is likely that the JCT report's exempt organization proposals will be a topic of discussion.

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