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July 12, 2013

### U.S. Senate Finance Committee Report Highlights Potential Tax Reforms for Tax-Exempt Organizations

On June 13, 2013, the majority and minority staffs of the U.S. Senate Finance Committee (the “Committee”) released a 19-page compilation of federal tax reform options addressing various rules and laws applicable to tax-exempt organizations and charitable giving. [Click here](#) to view the Committee’s report. This report does not represent a particular plan or approach suggested by the Committee staff; rather, it includes a wide variety of reforms suggested in the past by bipartisan commissions, tax policy experts, members of Congress, and witnesses at Committee hearings. Thus, while not reflecting current or proposed law, the report nevertheless merits attention and discussion as a closer look at the types of reforms that the Committee is likely to consider as it delves further into tax reform efforts.

#### Goals and Concerns

The report lists six broad areas of concern that pertain to the tax-exempt community. These issues include the fairness of the current charitable contribution deduction mechanism; the economic efficiency of that deduction in its current form; the extent to which certain tax-exempt organizations may currently engage in political activity; the overall public and societal benefits arising from the tax-exempt sector; the question of whether tax-exempt organizations compete unfairly with taxable counterparts, notwithstanding the unrelated business income tax (“UBIT”) regime designed to minimize such unfairness; and a perceived lack of accountability and oversight of tax-exempt organizations that allows for waste, fraud, and abuse. At the same time, the report notes “several potential goals that could serve as guidelines for the Committee when reviewing the tax rules for exempt organizations and charitable contributions.” Those goals include:

- Maximizing the efficiency and effectiveness of charitable giving incentives;
- Considering the expansion of such incentives to reach more taxpayers;
- More tightly aligning tax-exempt status with the provision of sufficient charitable benefits;
- Closely examining the relationship between political activity and exempt status;
- Reconsidering the level of permissible commercial activity for tax-exempt entities; and
- Improving accountability and oversight of the tax-exempt sector.

In short, it appears that the Committee may focus most closely on determining the extent to which the tax laws should incentivize charitable giving by taxpayers, while at the same time re-examining the role of tax-exempt organizations and their permissible scope of activities.

#### Reform Options

As noted above, the report does not identify suggestions or approaches particularly favored by the Committee staff. Rather, it lists (with links to more specific, detailed information) numerous suggestions presented to the Committee during its information-gathering hearings. The report specifically states that “the options listed are not necessarily endorsed by either the Chairman or Ranking Member” of the Committee.

The Committee’s discussion of the tax reform options is divided into four general categories: charitable deductions; taxation of business activities of nonprofits; the political and lobbying activities of tax-exempt organizations; and “broad tax-exempt issues.”

#### I. Charitable Deductions

The recommendations with respect to the charitable deduction rules span a wide spectrum of views. The report includes links to materials advocating for the repeal of the deduction; the fundamental reform of the deduction (including mechanisms such as caps, “matches” to recipient charities, or reclassification of the deduction as a credit); ways to increase the incentives for charitable giving; and incremental reforms (including simplification of the deduction, changes to the rules for non-cash contributions, the disallowance of deductions for contributions made to support commercial activities,

new rules for conservation easements, rules pertaining to tax-free individual retirement account distributions to charity, and reforms to the reporting and valuation rules).

## **II. Taxation of Business Activities of Exempt Organizations**

The taxability of “business activities” carried on by tax-exempt organizations depends on the underlying relationship between those activities and the purposes justifying the organization’s exempt status. UBIT is the primary tool by which exempt organizations are not permitted to unfairly compete with taxable entities. That being said, the UBIT regime includes numerous exceptions. The report cites to materials in which commentators have suggested various opportunities for reform in this area. Some examples include a suggestion to tax all commercial activities of exempt organizations; views on whether the tax-exempt status for fee-for-service organizations (including nonprofit hospitals and credit counseling organizations) should be disallowed or subject to new requirements; proposed revisions to the UBIT rules; new, tighter standards for tax-exempt organizations that choose to convert to taxable, for-profit status; and eliminating the tax-exempt status of professional sports leagues under Section 501(c)(6).

## **III. Political Activity and Lobbying of Tax-Exempt Organizations**

There has been much recent attention on when and how tax-exempt organizations may engage in political activity and/or lobbying. The report includes views recommending that organizations exempt under Sections 501(c)(4), (5), and (6) be limited in their political activities, either by a percentage-of-expenditure test or through increased disclosure obligations. Other cited options include various changes to the categories of exempt organizations that may engage in political activities, as well as reforms to the reporting and disclosure rules that apply to such organizations. Likewise, the report includes links to materials on the exclusion from gift tax for payments to Section 501(c)(4) organizations, and the expansion of the prohibition on federal funds being paid to Section 501(c)(4) entities that lobby.

## **IV. Broad Tax-Exempt Issues**

The final section of the report includes an assortment of issues that pertain to tax-exempt organizations. These include proposals to modify the private foundation excise tax on net investment income; proposed rules for the taxation of endowments held by tax-exempt organizations; new rules applicable to donor-advised funds and supporting organizations; limits on executive compensation paid by tax-exempt organizations; various changes to the ways in which organizations file Form 990 information returns and make the information contained therein accessible to the public; and new enforcement tools other than revocation of tax-exempt status.

## **Conclusion**

In summary, this Committee report identifies areas of potential tax reform that could directly and significantly – and, in many cases, adversely – affect the entire tax-exempt community. While a number of the suggestions aggregated in the report are familiar “discussion points” within the tax-exempt sector, it is noteworthy that these varied approaches to reform have made their way to the Committee and been included in its report. We will continue to monitor these issues as the Committee proceeds in its analysis and deliberations.

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