

AUTHORS

George E. Constantine
Jeffrey S. Tenenbaum
Mark S. Goodrich

RELATED PRACTICES

Tax-Exempt Organizations
Tax and Wealth Planning

RELATED INDUSTRIES

Nonprofit Organizations
and Associations

ARCHIVES

2014 2010 2006
2013 2009 2005
2012 2008 2004
2011 2007

Articles

February 2014

Key House Committee Chairman Releases Long-Awaited Tax Reform Overhaul: Major Changes Proposed for Nonprofits

On February 26, 2014, U.S. House of Representatives Ways and Means Committee Chairman Dave Camp released "[The Tax Reform Act of 2014](#)," a 979-page sweeping federal tax reform package that, among many other things, addresses a number of rules and laws applicable to tax-exempt organizations, and could impose significant new tax liabilities on nonprofits. While not expected to even be voted on this year, many of the proposals could well find their way into law as part of any future federal tax legislation and many of the exempt-organization-related proposals would fundamentally change the tax obligations of nonprofits.

The legislation proposes changes that impact both tax-exempt organizations and contributors to exempt organizations. The Act would amend which activities and organizations are subject to unrelated business income tax and would impose a variety of new excise taxes and modifications of current excise taxes on certain nonprofit organizations and activities. The legislation also proposes changing the tax-exempt status of certain organizations and seeks to increase the penalties related to IRS Forms 990 and underpayment of unrelated business income tax. Finally, it would introduce a 2% floor on individual charitable contributions.

We have summarized key aspects of the proposed legislation below. For more detail, the Joint Committee on Taxation's technical explanation of the bill is available [here](#). In addition, see the section-by-section summary written by the staff of the House Ways and Means Committee [here](#).

Unrelated Business Income Tax

The proposed legislation would bring some significant changes to what income is treated as unrelated business taxable income, most notably relating to tax-exempt royalties and tax-exempt corporate sponsorship payments, as well as to the ability to aggregate unrelated business income gains and losses.

Royalties

Currently, the payments received from the licensing of a nonprofit's name and logo are not treated as subject to the unrelated business income tax (UBIT), but under the new legislation, fees from the licensing of an organization's name or logo would be treated as expressly subject to UBIT. Other forms of royalty income (e.g., from the license of an association's copyrighted materials) would not be affected by this proposal. Many nonprofits have developed significant royalty revenue streams over the years through the license of their names and logos; this proposal would present a significant new tax burden to those entities.

Corporate Sponsorships

Further, the Act proposes to amend the manner in which corporate sponsorship revenue is treated. Under current law, a nonprofit may receive non-taxable sponsorship payments and, in exchange, give certain benefits to the sponsor without fear of those payments being treated as taxable advertising revenue. The benefits that are permitted under the sponsorship safe harbor under current law include the use or acknowledgment by a tax-exempt organization of, and reference to, the sponsor's name, logo, product lines, and other similar items. The proposal would remove "product lines" from the allowable items. In addition, the proposal would put in place a restriction on how a sponsor's name is used or acknowledged when the organization receives more than \$25,000 for the sponsorship of a single event. Under that scenario, a sponsor's name may only appear in the same manner as the other donors to the event. This provision appears to be focused squarely on sponsorships offered for college football bowl games and could have the effect of either doing away with the assignment of naming rights for such games or taxing the income received from the sale of such naming rights.

UBIT Deductions

Another notable proposal for the nonprofit community is a provision that would require tax-exempt organizations to compute UBIT separately for each unique activity that is subject to the tax. Thus, a tax-exempt organization would no longer be able to apply losses from one unrelated activity to offset gains from other such activities.

Other UBIT Provisions

The legislation provides several other items related to unrelated business income, including the following:

- Repeals the current exclusion from unrelated business taxable income of gains or losses from the disposition of real property acquired from financial institutions or receiverships, which would prevent charitable organizations that own certain real property from avoiding taxes on gains from the sale;
- Modifies the exclusion of research income from unrelated business income to only allow for such exclusion where the research results are made freely available to the public;
- Modifies the charitable deduction percentage limit applicable to certain charitable trusts for purposes of calculating UBIT; and
- Increases the specific deduction against unrelated business taxable income from \$1,000 to \$10,000.

Excise Taxes and Intermediate Sanctions

Changes to Intermediate Sanctions

Currently, if there are excessive benefits paid to certain insiders of section 501(c)(3) and 501(c)(4) organizations, an excise tax may be imposed on those individuals who so benefit as well as on those organization managers who approved those benefits. These provisions, which have come to be known as "intermediate sanctions," were enacted by Congress in 1996 as part of an attempt to give the IRS a more effective enforcement tool to guard against inappropriate payments and benefits being made to tax-exempt organization leaders and insiders. The Act proposes sweeping new changes to the intermediate sanctions regime, including:

- Expanding the coverage of the provisions so that it also applies to 501(c)(5) and 501(c)(6) organizations;
- Adding a new excessive benefits excise tax, equal to 10% of the excess benefit, on the organization if certain minimum standards of due diligence or other procedures were not followed;
- Doing away with the current law "rebuttable presumption of reasonableness," which gives a presumption that a transaction is not excessive if certain steps are followed;
- Doing away with the "professional advice" safe harbor for managers who approve a transaction after relying on professional advice; and
- Expanding the definition of who is an insider (the term used in the tax code for insider is "disqualified person") to include athletic coaches and investment advisors.

Compensation Tax

Perhaps most notably, the legislation would impose an excise tax of 25% on executive compensation (including any parachute payments) over \$1 million, to be paid by the organization. This excise tax would apply to any of the five highest compensated employees of any tax-exempt organization. This proposal is characterized in the supporting materials as one that brings tax-exempt organization compensation rules in line with the tax-deductibility rules currently in place for taxable, publicly traded entities.

Other Changes

The legislation also would make the following excise tax changes:

- Requires contributions to donor-advised funds to be distributed within five years and imposes a tax equal to 20% of the contribution that has not been distributed;
- Imposes private foundation excise tax on self-dealing of 2.5% of the amount involved and eliminates special rule that a manager's participation is usually not "knowing" for purposes of self-dealing excise taxes;
- Lowers the excise tax on net investment income for private foundations to 1%;
- Repeals the exception for private operating foundations that fail to distribute income; and

- Imposes an excise tax of 1% on private educational institutions that have assets of at least \$100,000 per full-time student based on fair market value.

Tax-Exempt Status of Organizations

The legislation would alter the tax-exempt status of several types of nonprofit organizations. First, it proposes repealing the tax-exempt status for professional sports leagues, such as the National Football League. The statutory language for section 501(c)(6) currently exempts "professional football leagues," but has been interpreted by the IRS to include professional leagues in other sports. All professional sporting leagues that are currently recognized as tax-exempt would be impacted. Further, certain stock property and casualty insurance companies and mutual property and casualty insurance companies (with certain gross receipts and premiums requirements) also would lose their tax exempt status, as would co-op health insurance issuers.

In addition, the proposed legislation also would repeal public charity status for Type II and Type III supporting organizations, limiting supporting organizations to ones that are operated, supervised, or controlled by their supported organizations.

Penalties

The legislation proposes to double penalties relating to failures to file IRS information returns (e.g., Form 990) and failures to make returns available for public inspection. The legislation would further impose a tax on managers under a duty to perform an act in which understatement of income tax occurs. Under the proposal, a manager who is liable must pay a tax of 5% of the underpayment attributable to the understatement.

Individual Charitable Contribution Floor

The legislation also would affect individual charitable contributors. The legislation provides for a 2% floor on charitable deductions, whereby the individual's charitable contributions could be deducted only to the extent they exceed 2% of the individual's adjusted gross income.