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# ***EOTS NewsFlash***

Exempt Organizations Tax Services

November 4, 2011

## *Fall 2011 tax legislative update for exempt organizations*

Against a backdrop of mounting budget pressures at the federal, state, and local levels; a deficit reduction "Supercommittee"; and the early phases of the 2012 presidential election cycle, a polarized Congress has also focused on the charitable sector, with some viewing tax-exempts and IRS administrative actions in this area as ripe for increased oversight and others concerned about the impact of deficit reduction proposals on nonprofits and charitable organizations.

In recent weeks, both the House and Senate tax-writing committees have placed significant emphasis on compliance and reform proposals that would directly impact tax-exempt organizations. Although the future direction of this focus on the tax-exempt sector is not immediately clear, the combination of articles concerning the effectiveness of IRS oversight of tax-exempt organizations appearing in the press and increased Congressional scrutiny suggest that future substantive and reform-based hearings may be expected.

### ***House Ways & Means Subcommittee on oversight***

On October 6, 2011, Congressman Charles Boustany, Jr., MD (R-LA), Chairman of the House Ways & Means Subcommittee on Oversight, sent a [letter to IRS Commissioner Shulman](#) requesting detailed information on five discrete areas pertaining to tax-exempt organizations: (1) Overview of the Tax-Exempt Sector; (2) Compliance; (3) Unrelated Business Income; (4) Audits; and (5) Current Tax-Exempt Enforcement Initiatives.

Chairman Boustany's request was issued in response to concerns expressed by certain Members of the Health and Oversight Subcommittees that "tax-exempt organizations may not be complying with the letter or the spirit of the tax-exempt regime, yet continue to enjoy the benefits of tax exemption."

Included within requests for procedural and statistical data are requests for information that will, if provided by Commissioner Shulman in his response, be of interest to many tax-exempt organizations.

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Specifically, Chairman Boustany has requested that Commissioner Shulman provide:

- a breakdown of all audits opened for each type of tax-exempt entity (including the issues identified for audit, the current status of such audits, and the average length of tax-exempt audits during the 2008-2011 periods);
- a detailed explanation of how the IRS is using the new information obtained from the redesigned Form 990 to improve current enforcement efforts and future compliance;
- a detailed description of new governance issues identified by the provision of additional information on the redesigned Form 990, if any;
- an explanation of the most common tax-exempt organization errors related to reporting trade or business income (in the context of UBTI);
- an explanation of how the IRS reviews allegations of excessive political campaign activity by tax-exempt organizations;
- descriptions of new tax-exempt compliance projects anticipated to launch in the coming year, if any;
- specific details regarding the nature and extent of excise taxes and penalties imposed on tax-exempt organizations between 2006 and 2010;
- information regarding the IRS's current plans to comply with its obligation to review hospital organizations under section 501(r) of the Internal Revenue Code and report to Congress regarding the level of charity care provided by all hospitals (taxable, charitable, and government); and
- information regarding the status of the final report on the colleges and universities compliance project.

**Note:** Given that many calendar-year organizations file their annual information returns on November 15 after filing Forms 8868 and applying for two three-month extensions, the data provided by Commissioner Shulman, if any, will not include complete information for the 2010 tax year, as was requested by Chairman Boustany.

### ***Senate Finance Committee hears testimony on "Tax Reform Options: Incentives for Charitable Giving"***

On October 18, 2011, the Senate Finance Committee held what may be the first in a series of hearings bearing directly on the proper form and function of the charitable contribution deduction within the context of tax reform legislation and, more broadly, on the role of the tax-exempt sector in America today.

In his opening remarks, Chairman Max Baucus (D-MT) highlighted the important role played by nonprofits and spoke of encouraging charitable giving "in a way that is fair and efficient." Senator Orin Hatch (R-UT), as Ranking Republican on the Finance Committee, expressed concern about the "quiet assault" being waged against the current deduction for charitable giving by those who are "hungry for more taxpayer dollars to finance reckless government spending." Senator Hatch expressed specific concerns about the potential impact on nonprofits and charitable giving from

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the Obama Administration's proposal to cap the value of individual itemized deductions at the 28 percent tax rate.

In this first hearing, Members of the Committee heard testimony from five witnesses:

- **Frank J. Sammartino**, Assistant Director for Tax Analysis, Congressional Budget Office (Washington, DC) ([Testimony](#))
- **Elder Dallin H. Oaks**, The Quorum of the Twelve Apostles, The Church of Jesus Christ of Latter-day Saints (Salt Lake City, UT) ([Testimony](#))
- **Dr. Eugene Steuerle**, Richard B. Fisher Chair and Institute Fellow, The Urban Institute (Washington, DC) ([Testimony](#))
- **Brian A. Gallagher**, President and CEO, United Way Worldwide (Alexandria, VA) ([Testimony](#))
- **Roger Colinvaux**, Associate Professor, The Catholic University of America, Columbus School of Law (Washington, DC) ([Testimony](#))

In his prepared testimony, which reprises the Congressional Budget Office's (CBO's) [May 2011 report](#), Mr. Sammartino explained that the cost of the charitable contribution deduction, as measured by the additional revenues that could be collected if the deduction was eliminated, will total about \$230 billion between 2010 and 2014.

In that May 2011 report, the CBO looked at 11 options for altering the current income tax treatment of charitable giving. Mr. Sammartino explained that these 11 options can be grouped into four categories: (1) retaining the deduction for itemizers but adding a floor; (2) allowing all taxpayers to claim the deduction, with or without a floor; (3) replacing the deduction with a non-refundable credit for all taxpayers, equal to 25% of a taxpayer's charitable donations, with or without a floor; and (4) replacing the deduction with a non-refundable credit for all taxpayers, equal to 15% of a taxpayer's charitable donations, with or without a floor.

Mr. Oaks expressed a concern that was echoed by other witnesses who appeared at Tuesday's hearing, that "the possible impairment of the charitable deduction in order to enhance tax revenues is not a religious issue. It is not a political issue. It is not even an economic issue. It poses a question about the nature and future of America." Addressing the possibility of the government making up some of the losses incurred by charitable organizations that would result from reductions to the charitable deduction, Mr. Oaks submitted that "most Americans would not have us relinquish the freedom and diversity of our vigorous private sector of charities in exchange for the assurance that the government would select and manage their functions."

Dr. Steuerle spoke of the signalling effect that any change in current tax policy would have and encouraged Members of the Committee to "give attention to the message [they] convey about the type of society [they] wish to encourage."

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Dr. Steurle also provided a list of 10 changes that could be included in a future legislative package, including:

- providing an improved reporting system to taxpayers for charitable contributions (potentially requiring charities to verify or place valuations on many, most, or all types of in-kind gifts);
- limiting the deductibility for in-kind gifts where the net amount to the charity is so low (because of payments to intermediaries) that the revenue cost to the government is greater than the value of the gift made;
- requiring electronic filing by most or all charities;
- allowing deductions to be given until April 15 or the filing of a tax return; and
- modifying private foundation rules to reduce and simplify excise taxes and change the payout rule so that it does not encourage giving in a pro-cyclical manner.

Mr. Gallagher, responding to the Administration's proposal to cap the current deduction at 28%, cited recent studies indicating that the proposed cap could result in a loss of charitable giving of between \$2.9 billion and \$5.6 billion each year. In his estimation, this loss would equate to "eliminating all of the private donations each year to the Red Cross, Goodwill, the YMCA, Habitat for Humanity, the Boys and Girls Clubs, Catholic Charities, and the American Cancer Society combined." Highlighting the sensitivity to tax rates felt by high-income taxpayers, Mr. Gallagher testified that "[i]f this Committee reduces the charitable deduction, you should expect that donors will simply withhold the difference necessary to cover the tax from their donations. A limit on the deductibility of charitable donations isn't really an increase in tax on the wealthy so much as it is a transfer to the government of money that would otherwise go to charities." In his view, "[t]he real impact will be felt by the people we serve."

Mr. Colinvault, whose prior experience includes serving as Legislation Counsel for the Staff of the Joint Committee on Taxation for tax matters that affect nonprofit organizations, explored the historical and contemporary relationships between the charitable contribution deduction and the public policies supporting the bases for tax-exemption for charitable organizations. He stressed the strong connection between the section 170 deduction and the 501(c)(3) bases for exemption, and recommended that Congress consider eliminating that link to tailor the tax subsidy to specific public benefit areas. In his view, potential reform to the charitable contribution deduction ideally would be "tackled as part of a comprehensive review of the sector and all sources of support--that is, including direct government spending, as well as tax policy regarding charitable giving, exemption, and tax-exempt financing."

Of the proposals discussed during the hearing, Mr. Colinvault favored the proposed imposition of an income-based floor, as this approach "appears best to fit within current policy tenets." In his view, the Administration's proposed 28% cap "would have the effect of embracing as a matter of policy the argument that the current deduction is unfair" and "the most likely outcome over time is that the deduction will be converted to a credit . . . because any pretense of an income measurement

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rationale for the deduction will have disappeared, placing increased pressure on continued unfairness that would still be represented by the rate structure."

Mr. Colinvaux's testimony also drew attention to the fact that certain types of organizations, namely those that rely heavily upon direct charitable contributions from the public as their primary source of support (e.g., organizations focused on the arts and environment), are more susceptible to fluctuations in direct charitable giving than are those that rely primarily on program service revenue (e.g., organizations focused on health care and education) and other sources of support. According to Mr. Colinvaux, although a 2008 study of high net worth individuals suggests that such persons are more likely to give to organizations that rely primarily on program service revenue (i.e., those that are less susceptible to fluctuations in direct charitable contributions), significant reductions in direct charitable giving following the implementation of any reform package could, if coupled with cutbacks from other sources, create the "perfect storm" for many section 501(c)(3) organizations.

In lieu of asking questions, [Senator Charles Grassley \(R-IA\) made a statement](#) during the hearing, explaining his view that the President's proposal to cap itemized deductions "is not a tax reform proposal" because it does not close any loopholes, "[i]t just discriminates against higher income taxpayers." Turning his attention to another area of the tax-exempt sector, Senator Grassley stated that a "review of donor advised funds and university endowments shows that, since the last major overhaul of the tax-exemption rules in 1969, there has been an explosion in asset-accumulating public charities that are not subject to pay-out requirements or other private foundation rules."

Separately, Senator Grassley motioned for inclusion in the record an October 17 [letter](#) he sent to Treasury Secretary Timothy Geithner and IRS Commissioner Shulman requesting that studies pertaining to supporting organizations that were mandated under the Pension Protection Act of 2006 and the finalization of supporting organization pay-out rules be prioritized and that his staff be briefed on the status of both projects as soon as possible.

In his closing remarks, Senator Grassley highlighted the recent publicity surrounding the investments by certain foundations in the failed solar energy firm Solyndra and requested that Chairman Baucus and Senator Hatch schedule another hearing to "examine the standards for tax-exemption and the increasingly blurred line between public charities and private foundations."

In response to a question from Senator Hatch, the witnesses were unanimous that the President's proposal to cap itemized deductions would reduce by a significant amount giving to charitable organizations. Mr. Colinvaux noted that the reduced giving from a cap on itemized deductions would impact most significantly those charitable organizations favored by upper-income taxpayers, and the range of organizations and activities affected should be considered.

Senator Ben Cardin (D-MD) asked about current policies regarding valuation of personal property gifts like automobiles, and whether better guidance can be given to donors of clothing and household items. In response, Dr. Steuerle noted that the amount of deductions for non-cash goods is large but the IRS is not in a good position to analyze the limited data in this area.

Senator Thune (R-SD) questioned whether any of the proposals to limit charitable deductions had adequately explored the increased cost to taxpayers for the government services that would be needed to replace services that charitable organizations might not be able to provide if charitable contributions decline as a result of the implementation of one or more of the proposals. Mr. Sammartino explained that the CBO's analysis did not look at this issue.

Senator Thune continued by referencing data provided by the Independent Sector which suggests that nonprofits employ 1 in 10 workers in the United States and questioned whether any analysis had been done with respect the impact on national unemployment for the 13 million jobs currently provided by the nonprofit sector. Mr. Sammartino's response confirmed that CBO has not looked at this side of the issue.

Additional information, including a video of the hearing, is available on the [Senate Finance Committee's website](#).

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