The principal source of specific tax reform proposals at the present is the proposed Tax Reform Act of 2014, introduced by the then-Chairman of the House Committee on Ways and Means Dave Camp (who has since retired from Congress). This proposal (Camp Proposal) was never introduced as a bill; it was published, on February 26, 2014, as a discussion draft. Tax reform proposals are also in the Administration’s proposed budget for fiscal year 2016, in items of tax law revision legislation that are pending in the current (114th) Congress, and in the July 2015 Report of the Business Income Tax Working Group to the Senate Committee on Finance (Working Group Report).

Tax reform proposals directly affecting the tax law pertaining to tax-exempt organizations are inventoried in the following list. (Proposals concerning the tax law of charitable giving are in a table that is part of the 2016 Cumulative Supplement accompanying The Tax Law of Charitable Giving, Fifth Edition.)

I. Tax Reform Proposals Affecting Public Charity Law

A. Type II and Type III Supporting Organizations

1. Present law: One of the several ways a tax-exempt charitable (IRC § 501(c)(3)) organization can be a public charity (IRC § 509(a)) is to qualify as a supporting organization (IRC § 509(a)(3)). Four basic tests must be satisfied for supporting organization status, one of which is the relationship test. Pursuant to this test, an organization must be (1) operated, supervised, or controlled by one or more qualified supported organizations (usually a form of public charity) (known as a Type I supporting organization); (2) supervised or controlled in connection with one or more qualified supported organizations (Type II supporting organization); or (3) operated in connection with one or more qualified supported organizations (Type III supporting organization). The classification of a supporting organization depends on how close its relationship is to the supported organization(s), with Type I supporting organizations having the closest relationship (being akin to a parent–subsidiary arrangement).

2. Proposal: Federal tax law authorizing Type II and Type III supporting organizations would be repealed (Camp Proposal § 5304). Thus, these entities would be required to either qualify as a public charity on another basis or be private foundations.

B. Intermediate Sanctions Rules

1. Present law: Penalty excise taxes may be imposed on disqualified persons who improperly benefited from excess benefit transactions with applicable tax-exempt organizations and on managers of the organization who participated in the transactions knowing they were improper.
2. Proposal: Rebuttable presumption of reasonableness and professional advice reliance safe harbor rule for managers would be eliminated.

C. Definition of Disqualified Person

1. Present law: For purposes of the intermediate sanctions rules, the term disqualified person means (1) any person who was, at any time during the five-year period ending on the date of the transaction involved, in a position to exercise substantial influence over the affairs of the organization; (2) a member of the family of an individual in the foregoing category; and (3) an entity in which individuals described in the preceding two categories own more than a 35 percent interest (IRC § 4958(f)(1)(C)).

2. Proposal: This definition of disqualified person would be expanded to include athletic coaches and investment advisors (Camp Proposal § 5201).

D. Donor-Advised Funds

1. Present law: A donor-advised fund is a fund or account (1) that is separately identified by reference to contributions of one or more donors; (2) that is owned and controlled by a sponsoring organization; and (3) as to which a donor or donor advisor has, or reasonably expects to have, advisory privileges with respect to the distribution or investment of amounts held in the fund by reason of the donor’s status as a donor (IRC § 4966(d)(2)(A)).

2. Proposal: Donor-advised funds would be required to distribute contributions within five years of receipt; penalty would be imposed for failure to meet this payout rule (Camp Proposal § 5203).

E. Private Colleges and Universities Investment Income Tax

1. Present law: No category of public charity is required to pay tax on its net investment income. A few other types of tax-exempt organizations, such as social clubs (IRC § 501(c)(7) entities) and political organizations (IRC § 527 entities) are subject to such a tax, as are private foundations (see II A).

2. Proposal: Large private colleges and universities would be subject to 1 percent excise tax on their net investment income (Camp Proposal § 5206).
TABLE OF TAX-EXEMPT ORGANIZATIONS LAW TAX REFORM PROPOSALS

F. Proposed Agricultural Research Organizations

1. Present law: There is no existing law for agricultural research organizations. They would be modeled on present law providing for medical research organizations (IRC § 170(b)(1)(A)(iii)), and thus would be public charities (IRC § 509(a)(1)) and be eligible for charitable contributions at the higher percentage limitations.

2. Proposal: Provision for these organizations would be created (proposed Charitable Agriculture Research Act (S. 908)). To qualify, an agricultural research organization would have to be engaged in the continuous active conduct of agricultural research (as defined in the Agricultural Research, Extension, and Teaching Policy Act of 1977) in conjunction with a land-grant college or university or a non-land-grant college or university. For a contribution to this type of organization to qualify for the 50 percent limitation, during the calendar year in which a contribution is made to the organization it must be committed to spend the contribution for this type of research before January 1 of the fifth calendar year that begins after the date of enactment. An agricultural research organization would be permitted to use the expenditure test (IRC § 501(h)) for purposes of determining whether a substantial part of its activities consist of carrying on propaganda or otherwise attempting to influence legislation.

II. Tax Reform Proposals Directly Affecting Private Foundation Law

A. Tax on Net Investment Income

1. Present law: Private foundations and certain charitable trusts are subject to a 2 percent excise tax on their net investment income (Internal Revenue Code of 1986, as amended, IRC § 4940(a)). An organization may reduce the excise tax rate to 1 percent by meeting certain requirements regarding distributions to qualifying tax-exempt organizations during a tax year (IRC § 4940(e)).

2. Proposal: This excise tax on net investment income would be reduced to a single rate of 1 percent (Camp Proposal § 5204).

3. The proposed America Gives More Act (H.R. 644), which was passed by the House of Representatives on February 12, 2015, would reduce this tax to 1 percent.

4. The Administration’s budget for fiscal year 2016 proposes reduction of this tax to a single rate of 1.35 percent (a budget-neutral percentage).

5. A proposal in the Working Group Report would reduce this tax to 1 percent.

B. Exempt Operating Foundations Excise Tax Exemption

1. Present law: Exempt operating foundations (IRC § 4940(d)(2)) are exempt from this excise tax on net investment income (IRC § 4940(d)(1)).

2. Proposal: This exemption would be repealed (Camp Proposal § 5204).
C. Expansion of Self-Dealing Tax Regime

1. Present law: Disqualified persons and managers who engage in self-dealing transactions with private foundations (IRC § 4941(d)) are subject to excise tax (IRC § 4941(a), (b)).

2. Proposal: An excise tax of 2.5 percent would be imposed on a private foundation when a self-dealing tax is imposed on a disqualified person. This tax rate would be increased to 10 percent in cases where the self-dealing involves the payment of compensation (Camp Proposal § 5202).

D. Foundation Managers’ Reliance on Professional Advice

1. Present law: A private foundation manager may avoid excise tax for knowingly participating in a self-dealing transaction (IRC § 4941(a)(2)) if the manager relies on advice provided by an appropriate professional, including lawyers, certified public accountants, and independent valuation experts (Treas. Reg. § 53.4941(a)-1(b)(6)).

2. Proposal: Foundation managers would no longer be able to rely on this professional advice safe harbor (Camp Proposal § 5202).

E. Private Operating Foundations’ Distribution Exception

1. Present law: Private foundations generally are required to pay out a minimum amount each year to accomplish one or more exempt purposes or for reasonable and necessary administrative expenses; there are excise tax penalties for failure to distribute (IRC § 4942). Private operating foundations (IRC § 4940(j)(3)) are not subject to these payout requirements; they have a different payout regime.

2. Proposal: Private operating foundations would be required to distribute income in accordance with rules for private foundations generally or be taxed (Camp Proposal § 5205).

F. Excess Business Holdings

1. Present law: A private foundation’s ability to own a business—one that is not conducted as an exempt function—is limited by rules concerning “excess business holdings” (IRC § 4943). The basic rule is that the combined ownership of a business enterprise, by a private foundation and those who are disqualified persons with respect to it, may not exceed 20 percent.

2. Proposal: An exception to these excess business holdings rules would be created for philanthropic business holdings (proposed Philanthropic Enterprise Act of 2015 (S. 909)). This pertains to a business enterprise that meets requirements relating to exclusive ownership, minimum distribution of net operating income for charitable purposes, and independent operation (i.e., enterprise not controlled by substantial contributors or family members).
G. Electronic Filing

1. Present law: Private foundations (including split-interest charitable trusts) that file at least 250 returns must file their annual information returns (Form 990-PF) electronically.

2. Proposal: All private foundations would be required to file Form 990-PF electronically (Camp Proposal § 6004).

3. A proposal in the Working Group Report would require all tax-exempt organizations to file all returns and the like in the Form 990 series electronically.

4. A proposal in the Working Group Report would require the IRS to make all information provided in this series available to the public in machine-readable format as soon as practicable.

H. Executive Compensation (see III)

I. Harmonization of Deduction Limitations (see IV B)

III. Tax Reform Proposals Affecting Executive Compensation

A. Present for-profit law: Deduction allowed to publicly traded C corporations for compensation paid with respect to chief executive officers and certain highly paid officers is limited to $1 million annually. Current law limits deductibility of certain severance-pay arrangements (parachute payments).

B. Present nonprofit law: Generally, the rule under private inurement doctrine is that compensation paid to insiders must be reasonable; penalty is loss of payor’s tax exemption. In the private foundation context, generally compensation to disqualified persons must be for personal services and be reasonable (IRC § 4941(d)(1)(D), (2)(E)); penalty is one or more self-dealing taxes (see I C 1). In public charity, social welfare organization, and health insurance issuer contexts, excessive compensation is subject to penalty taxes and other intermediate sanctions rules (IRC § 4958).

C. Proposal: A tax-exempt organization would be subject to 25 percent excise tax on compensation in excess of $1 million paid to any of its five highest-paid employees for the tax year. This tax would apply to all remuneration paid to a covered person for services, including money and cash value of all remuneration (including benefits) paid in a medium other than cash, except for payments to a tax-qualified retirement plan and amounts that are excludable from the executive’s gross income. Once an employee qualifies as a covered person, excise tax would apply to compensation in excess of $1 million paid to that person as long as the exempt organization pays the person compensation (Camp Proposal § 3803).

D. Proposal: An excise tax would apply to excess parachute payments paid by exempt organizations to covered persons. An excess parachute payment...
generally would be defined as a payment contingent on the employee’s separation from employment with an aggregate present value of three times the employee’s base compensation or more (id.).

IV. Other Tax Extender

A. Modification of tax treatment of certain payments to controlling tax-exempt organizations. In general, interest, rent, royalties, and annuities paid to an exempt organization from a controlled entity are treated as forms of unrelated business income of the exempt organization (IRC § 512(b)(13)). A special rule (that expired at the close of 2014) provided that, if these payments are no more than at fair market value, the payment is excludable from the exempt organization’s unrelated business income (IRC § 512(b)(13)(E)).

B. This special provision would be extended for two years (through 2016) by tax extenders legislation approved by the Senate Committee on Finance on July 23, 2015.

V. Other Working Group Reform Proposals

A. Extension of declaratory judgment procedure (IRC § 7428) to the initial determination or continuing classification of organizations as tax-exempt to all categories of tax-exempt organizations (IRC § 501(c), (d) entities).

B. An organization may seek a declaratory judgment from the U.S. Tax Court in the case of any type of determination or failure to which the declaratory judgment rules currently apply.

C. An organization could seek a declaratory judgment from the U.S. District Court for the District of Columbia or the U.S. Court of Federal Claims only in the case of determinations or failures relating to the following:

1. Initial qualification or continuing classification of an organization as a charitable entity (IRC §§ 501(c)(3), 170(c)(2)).

2. Initial qualification or continuing classification of an organization as a private foundation or private operating foundation.

3. Initial qualification or continuing classification as a farmers’ cooperative (IRC § 521(b)).