Tax Reform Proposal Could Significantly Impact Associations

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Q: I understand that Congress is considering a comprehensive tax reform proposal. Will it affect nonprofits?

A: On Feb. 26, 2014, U.S. House Ways and Means Committee Chairman Dave Camp (R-Mich.) released a first draft of the comprehensive "Tax Reform Act of 2014." The proposed legislation would significantly impact associations and other tax-exempt organizations, reducing the top corporate tax rate from 35 to 25 percent and lowering the top individual tax rate from 39.6 to 35 percent (25 percent for 99 percent of taxpayers). For the proposal to make economic sense, however, Congress must generate tax revenue in other ways. Several changes to the rules affecting tax-exempt entities have been proposed:

- Royalties received on the sale or license of a tax-exempt organization's name and logo would be subject to unrelated business income tax. Supporters assert that by lending their name and logo to a trade or business, many nonprofits currently earn significant profits from commercial activities. While one could argue whether licensing actually constitutes "commercial" activity, the proposed change would affect a broad range of non-dues revenue generating activities for associations and other exempt organizations. The non-partisan Joint Committee on Taxation predicts implementation of the proposal would increase tax revenue by $1.8 billion over the next 10 years.
- Tax-exempt organizations that carry on more than one trade or business would be required to calculate the net taxable income of each trade or business separately, rather than use a loss from one business to offset gains from another. That change, according to the JCT, would likely produce an additional $3.2 billion in tax revenue from 2014 through 2023.
- Income derived from a research business would be exempt from UBIT only if the research is made publicly available. Under current law, research income also is exempt if the research is performed for a state or federal government, or any of their divisions, or if the research is performed for a college, university or hospital, whether or not the results are publicized.
- The scope of qualified sponsorship payments exempt from UBIT would shrink. Specifically, if an acknowledgement refers to the business sponsor's product lines, the payment would be treated as advertising, not qualified sponsorship, income. Also, if an association or other tax-exempt entity were to receive more than $25,000 in qualified sponsorship payments for a single event, an individual sponsor's name and logo would need to appear with and in the same manner as those of a "significant portion" of the other donors. That approach would make "exclusive sponsorship" payments subject to UBIT.
- The excise tax on excess benefit transactions would apply not only to organizations exempt under Section 501(c)(3) of the Internal Revenue Code, but also to organizations exempt under Sections 501(c)(5) and 501(c)(6)—labor groups and most trade associations. Under the proposal, a tax-exempt organization would be liable for an excise tax of 10 percent whenever the excess benefit tax is imposed on a disqualified person associated with the organization. In addition, an organization paying any of its five highest compensated employees more than $1 million in cash and benefits annually would be subject to a 25 percent excise tax on the excess amount.
- The tax exemption for qualified property and casualty insurers and qualified health insurers would be eliminated.
- All organizations that file Form 990 information returns would be required to file electronically, and daily penalties for failure to file would double.
- The distinctions among Type I, Type II and Type III supporting organizations would be eliminated. Beginning in 2016, only Type I organizations would qualify as supporting organizations; Type II or Type III organizations that could not requalify as public charities or as newly-defined supporting organizations would be treated as private foundations.
- Individuals could deduct charitable contributions for a prior year if contributions are made by the return due date. However, such contributions could be deducted only to the extent they exceed 2 percent of the individual's adjusted gross income. The House Ways and Means Committee suggests the proposal would increase charitable giving by $2.2 billion annually.

Although the proposal is a result of more than 30 Congressional hearings and 11 bipartisan tax reform working groups, it is a ways from becoming law. For now, it's important associations become familiar with the proposal and provide lawmakers with feedback on provisions that affect associations and other exempt organizations.

The answers provided here should not be construed as legal advice or a legal opinion. Consult a lawyer concerning your specific situation or legal questions.