Second Annual Nonprofit Executive Summit:

Bringing Nonprofit Leaders Together to Discuss Legal, Finance, Tax, and Operational Issues Impacting the Sector

Thursday, October 2, 2014
Venable LLP
Washington, DC

Nonprofit Executive Summit Agenda

Panel 1. Fraud and Embezzlement: The Executive Team's Role in Detecting, Reporting, and Preventing Fraud

Panel 2. Executive Employment Contracts: Getting Compliant and Creative

Keynote. Midterm Landscape 2014

Panel 3. Nonprofit Tax Issues: Where the IRS Is Today, and Where Congress Is Headed

Panel 4. Best Practices for Enhancing the Nonprofit Governance Model

Panel 3

Nonprofit Tax Issues:
Where the IRS Is Today,
and Where Congress Is Headed

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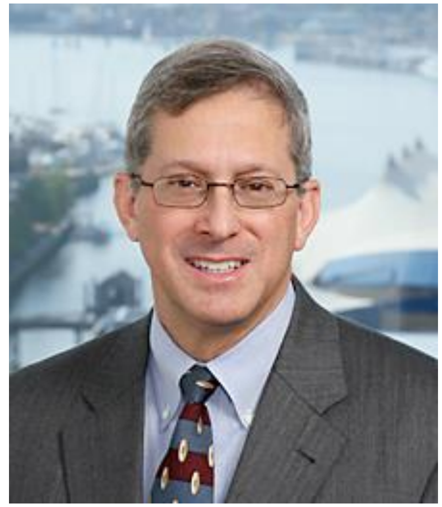
CliftonLarsonAllen

Moderator



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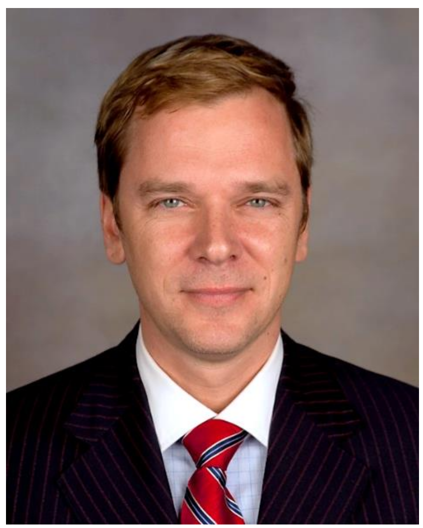

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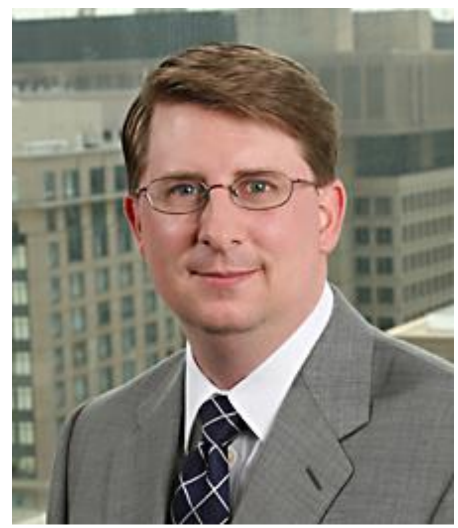

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IRS Developments

Lois Lerner

- How it began:
  - The IRS failed to rule on exemption applications filed by organizations that were potentially going to engage in political activities
  - The IRS identified such entities by looking for certain words in the organization's name

- What is the result:
  - IRS officials: Individuals were fired, individually named in lawsuits, and Lois Lerner has been called to testify (or not testify) before Congress on numerous occasions
  - New leadership with far less EO specific experience
  - EO Division: Has been attacked for bias, has been attacked for losing and/or destroying emails, and has been portrayed as incompetent and/or corrupt

Lois Lerner

- Problems:
  - A less knowledgeable EO leadership team
  - A more timid EO leadership team
  - A focus on clearing the decks, not reaching the correct results
- Opportunities:
  - Less enforcement
  - Lack of follow through on prior enforcement initiatives
  - Focus on clearing the decks

Religious Organizations

- How it began:
  - The IRS was sued several times in the last few years by organizations seeking for the IRS to engage in greater enforcement initiatives against religious organizations.

- What is the result:
  - The IRS and DOJ have announced an increase in enforcement efforts against religious organizations.

Automatic Revocation

- How it began:
  - As of 2010, organizations that failed to file a Form 990 or Form 990-N for three consecutive years were automatically revoked.
  - The IRS revoked many, many entities that should not have been revoked.
  - The IRS failed to adequately prepare for the impact of applications for reinstatement recognition of exempt status by automatically revoked organizations or establish procedures for correcting erroneous revocations.

- What is the result:
  - Significant delays
  - Less thorough reviews of exemption applications
  - Creation of Form 1023-EZ

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Impact on Exempt Organizations

Impact of IRS Developments

- A lack of published IRS guidance
- Fewer enforcement initiatives
- Less focus on applications for recognition of tax-exempt status
- Enforcement focus on religious organizations

What Does This Mean for You?

- The IRS is less focused on enforcement now.
  - When looking at potential risks of activities and tax positions, one consideration must be the lack of IRS enforcement.
  - The lack of industrywide programs may mean less lead time prior to an examination.
- The IRS review of applications is less involved now.
  - Now is the time to file a Form 1023 or Form 1024.
- The IRS has not gone away.
  - Pay attention to public reports about your organization or industry.

Current Focus of IRS Enforcement

Areas of IRS Focus

- Church audits
- Executive compensation
- Political activities
- Unrelated business income
  - Income and expenses allocation
  - NOLs

Factors Affecting Tax Reform

Factors Affecting Tax Reform

- FOR
  - Complexity causes errors
  - Complexity impedes collection
  - Complexity is expensive

- AGAINST
  - Elections
  - Political will
  - Lowering rates, broadening the base, maintaining revenue neutrality

Principles of Good Tax Policy

1. *Equity and Fairness.*
   Similarly situated taxpayers should be taxed similarly.
2. *Certainty.*
   The tax rules should clearly specify when the tax is to be paid, how it is to be paid, and how the amount to be paid is to be determined.
3. *Convenience of Payment.*
   A tax should be due at a time or in a manner that is most likely to be convenient for the taxpayer.
4. *Economy in Collection.*
   The costs to collect a tax should be kept to a minimum for both the government and taxpayers.
5. *Simplicity.*
   The tax law should be simple so that taxpayers understand the rules and can comply with them correctly and in a cost-efficient manner.
6. *Neutrality.*
   The effect of the tax law on a taxpayer's decisions as to how to carry out a particular transaction or whether to engage in a transaction should be kept to a minimum.
7. *Economic Growth and Efficiency.*
   The tax system should not impede or reduce the productive capacity of the economy.
8. *Transparency and Visibility.*
   Taxpayers should know that a tax exists and how and when it is imposed upon them and others.
9. *Minimum Tax Gap.*
   A tax should be structured to minimize noncompliance.
10. *Appropriate Government Revenues.*
    The tax system should enable the government to determine how much tax revenue will likely be collected and when.

AICPA, Guiding Principles for Good Tax Policy: Framework for Evaluating Tax Proposals, 2001; http://www.aicpa.org/taxreform.

Charitable Donation Deduction

- Charitable donations are an itemized deduction
- Generally the fair market value of the gift
  - Deduction Rate = Marginal Tax Rate
  - Applies to most gifts of appreciated property
- Limitations
  - Cash contributions up to 50% of AGI
  - Capital gain property up to 30% of AGI
  - Pease Limitation

The Problem

- 3 people donate $100 to the Save the Whales Foundation
  - Mrs. Bellevue earns $20,000,000 and owns a mansion. Her donation costs her $60 after taxes.

  - Mr. Maplewood earns $100,000 and owns a condominium. His donation costs him $72 after taxes.

  - Mrs. Fishtown earns $20,000 and lives in an apartment. Her donation costs her $100 after taxes.

Nonprofit Reform Proposals

Previous Proposals

- Reduce the tax benefit for the wealthy
  - Lower the AGI limit
  - Cap the value of the benefit (28%)
  - Hard Dollar Cap ($25,000)
  - Create a floor
- Increase the tax benefit for the non-wealthy
  - Permit deductions for non-itemizers
  - Permit charitable donations to be withheld/reported on W-2
- Equalize and limit the tax benefit to all
  - Eliminate entirely
  - 12 percent tax credit

Current Proposals

Raise the standard deduction

Thresholds	Single	Household
Current Law	$6,200	$12,400
Proposed Law	$11,000	$22,000

- Only 5% of taxpayers expected to itemize(currently 30%)
- Presumed charitable deduction “baked in”
- Elimination of charitable deduction for many

Illustration #1

- Household AGI: $200,000 (28% bracket)
- Rent
- Charitable gifts: $20,000

Under current law:

Itemize deductions: Pay $50,400 in tax

Standard deduction: Pay $52,528 in tax

Under proposed law:

Tax is $49,840 using the standard deduction

- Will the donor give $20,560?
- Or $0?

Current Proposals

2% Floor

- Deduction can only be claimed on contributions that exceed 2% of AGI
- Does not affect giving at margin
- Interacts with new standard deduction

Illustration #2

- Household AGI: $400,000 (33% bracket)
- Charitable gifts: $15,000
- Mortgage interest: $13,000

Under current law:

Itemized deductions

Proposed law:

Standard deduction of $22,000

(2% floor is $8,000, so itemized deductions would only be $20,000)

Other Proposals

- Reduce AGI limits on charitable deductions
  - Current law: Cash donations up to 50% of AGI
    Capital gain property donations up to 30% of AGI
  - Proposed law: Cash donations up to 40% of AGI
    Capital gain property donations up to 25% of AGI
- Many noncash gifts would be valued at the donor's basis instead of FMV
- Gifts of real estate would be limited to basis
- Deny any deduction that includes athletic tickets

Timing of Gifts

Current law: Gifts must be made within the tax year.

Proposed law: Gifts must be made prior to the due date (April 15) for the individual’s income tax return for the tax year.

Executive Compensation

Current law: Organizations may follow the "rebuttable presumption of reasonableness"

Proposed law: 25% excise tax on compensation in excess of $1 million paid to 5 highest paid employees

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Endowments

Current law: No excise tax on endowments

Proposed law: 1% excise tax on the net investment income of private colleges and universities with endowments greater than $100,000 per full-time student

Royalties

Current law: Income derived from the sale or licensing of a tax exempt organization's name or logo is excluded from unrelated business taxable income.

Proposed law: Name and logo royalties would be subject to UBIT

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Sponsorships

Current law: A qualified sponsorship payment (QSP) is not UBI.

Proposed law: A QSP may not acknowledge the sponsors' products. A QSP greater than $25,000 may not receive greater benefits than the majority of other sponsors.

Other Provisions

- Double the late filing penalty for nonprofit information returns.
- Eliminate exemption for Type II and Type III supporting organizations.
- Require that donor-advised funds be distributed within five years.

UBI Provisions

- Research income is UBI unless the results are made freely available to the public.
- Advertising expenses amortized over 10 years
- Losses from one UBI trade or business may not offset gains from another.
- 5% accuracy-related penalty on managers for substantial understatement of UBIT

UBI Provisions

- Raises the specific deduction from $1,000 to $10,000
- Reduces the top tax rate from 35 percent to 25 percent by 2019
- Allows net operating losses to offset only 90 percent of taxable income
- Repeals the alternative minimum tax

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Upcoming Venable Nonprofit Legal Events

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October 21, 2014 – Fundraising 201: An Update on Managing the Legal Risks of Nonprofit Fundraising

November 19, 2014 – Enhancing the Nonprofit Governance Model: Legal Pitfalls and Best Practices

December 11, 2014 – LGBT, Religion, and Diversity in the Nonprofit Workplace

Thank You!

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