



Tax Developments and Trends

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Topics

- Legislative Developments
- Administrative Developments
- IRS Regulations, Rulings, and Other Guidance
- New Case Law
- Looking Forward

Legislative Developments

Protecting Americans from Tax Hikes Act of 2015 (PATH Act)

- The legislation includes a permanent extension of the basis adjustment to stock of S corporations making charitable contributions of property. The extension is effective retroactive to taxable years beginning after December 31, 2014.
- The legislation also includes a requirement that the Treasury Department prescribe procedures under which an organization that claims to be described in section 501(c) may request an administrative appeal of an adverse determination of tax-exempt status, private foundation classification, and private operating foundation classification.

CHARITY Act (S. 2750)

- Charities Helping Americans Regularly Throughout the Year Act
- Referred to Senate Finance Committee on April 6, 2016
- Key provisions:
 - Provides that it is the sense of the Senate that encouraging charitable giving should be a goal of tax reform and Congress should ensure that the value and scope of the deduction for charitable contributions is not diminished during a comprehensive rewrite of the tax code
 - Permits qualified charitable distributions to include distributions from an IRA to a donor-advised fund
 - Modifies the tax rate for the excise tax on investment income of private foundations to a 1% flat rate
 - Imposes mandatory electronic filing for annual returns of exempt organizations
 - Permits the Secretary to determine the standard mileage rate for charitable deductions in line with the standard mileage rate used for medical and moving expenses deduction

CHARITY Act (cont'd)

- Provides an exception from excess business holding taxes for certain philanthropic business holdings
- To qualify for the exception, the philanthropic business enterprise must meet three requirements:
 - Exclusive Ownership Requirement
 - (1) All ownership interests in the business enterprise are held by the private foundation at all times during the taxable year; and
 - (2) All the private foundation's ownership interests in the business enterprise were acquired under the terms of a will or trust.
 - All Profits to Charity Requirement
 - The business enterprise must distribute an amount equal to its net operating income for the taxable year to the private foundation within 120 days after the close of the taxable year.
 - Independent Operation Requirement
 - The private foundation and the business enterprise must be tests for independence from disqualified persons and management.

Corporate Integration Proposal

- The Senate Finance Committee is reportedly drafting a legislative proposal to integrate the corporate and individual tax systems.
- The goal is to eliminate the “double taxation” of corporate earnings.
 - Corporate earnings are currently taxed once at the corporate level and again when distributed to shareholders as dividends
- The proposal would:
 - Allow U.S. corporations to deduct dividends and continue to deduct interest paid to shareholders and bondholders
 - Effectively eliminating or reducing the corporate-level tax
 - Require corporations to withhold on dividends and interest at a 35% tax rate
 - Allow shareholders and bondholders to claim a nonrefundable tax credit equal to the amount withheld

Corporate Integration Proposal (cont'd)

- Under current law:
 - Interest paid to tax-exempt bond holders is deductible at the corporate level and exempt at the bond-holder level
 - Dividends paid to tax-exempt shareholders are taxed at the corporate level and exempt at the shareholder level
- Impact of proposal on tax-exempt organizations:
 - Indirectly taxes tax-exempt shareholders and bondholders because:
 - Credit can be used only against interest and dividend income which is already exempt
 - Credit is nonrefundable.
 - Note: proposal in drafting stage but complete exclusion of tax-exempts, including pension plans, would be costly

CREATE Act of 2016 (S. 2648)

- Comprehensive Resources for Entrepreneurs in the Arts to Transform the Economy Act of 2016
- Referred to the Senate Finance Committee on March 8, 2016
- Creates a special rule to allow for a deduction from gross income equal to fair market value for all charitable contributions of any literary, musical, artistic, or scholarly composition, or similar property, or the copyright thereon (or both)

Other Legislative Developments

- Grow Philanthropy Act of 2016 (H.R. 4907)
 - This bill would permit tax-free distributions from individual retirement plans to donor-advised funds.
 - It would apply to distributions made in taxable years beginning after December 31, 2016.
- House Resolution 668
 - “Expressing the sense of the House of Representatives that philanthropy is an integral partner to government with a unique and proven ability to foster innovation, strengthen civil society, and build thriving communities.”
- Preventing IRS Abuse and Protecting Free Speech Act (H.R. 5053)
 - Bill would limit contributor information reported by a section 501(c) tax-exempt organization on its annual information return by eliminating Schedule B.

Camp Tax Reform Proposal

- Tax Reform Act of 2014
 - Former House Ways and Means Committee Chairman Dave Camp released draft tax reform legislation in 2014.
 - Camp Proposal is viewed as a starting point for future tax reform.
 - The plan included significant proposed changes for private foundations, donor advised funds and supporting organizations, including:
 - Imposing an entity-level tax on foundations that engage in self-dealing;
 - Reducing the excise tax rate on net investment income for foundations to 1 percent;
 - Requiring private operating foundations to follow the distribution rules of private foundations;
 - Repealing provisions for Type II and Type III supporting organizations, so these organizations would be treated as private foundations; and
 - Requiring donor advised funds to distribute contributions within five years of receipt. Failure to make a distribution would result in an annual tax of 20 percent of the undistributed funds.

Strained Relations Between Congress and the IRS

- Reduced budget
 - The IRS budget has been cut by 17% since 2010, after adjusting for inflation.
 - The IRS has been forced to reduce its workforce, decrease individual and business audit levels, and delay information technology systems upgrades.
- Calls for Impeachment of Commissioner Koskinen
 - Last October, Republican chairman of the House Oversight and Government Reform Committee Rep. Jason Chaffetz introduced a resolution to impeach IRS Commissioner John Koskinen.
 - He has renewed the call as recently as April 16th; however, Congressional leadership has not pushed the resolution forward

Administrative Developments

President's Fiscal Year 2017 Budget

- EO Highlights:
 - Increase funding for the IRS by roughly \$1 billion (9%), targeted to improve taxpayer services and enforcement.
 - Replace the two-tier excise tax (2%/1%) on net investment income of private foundations with a uniform 1.35% tax.
 - Limit deduction on itemized deductions, including the charitable deduction, and specified deductions or exclusions, to 28%.
 - Consolidate contribution limitations for charitable deductions by retaining the 50% limitation for contributions of cash to public charities and applying a 30% deduction limitation for all other contributions.
 - Extend the excess contribution carryover period from 5 to 15 years.
 - Make e-filing mandatory for exempt organizations.
 - Modify Form 1098-T reporting of scholarships issued by providers that are not processed by institutions of higher education.

IRS 2015-2016 Priority Guidance Plan

- Third quarter update released April 29, 2016
- Provisions relevant to private foundations:
 1. Revenue procedures updating grantor and contributor reliance criteria under sections 170 and 509.
 2. Guidance under section 4941 regarding a private foundation's investment in a partnership in which disqualified persons are also partners.

IRS EO Division Report on Fiscal Priorities

- In 2016, EO will focus resources on three strategic issue areas concerning private foundations:
 - Exemption
 - Non-exempt purpose activity and private inurement
 - Protection of Assets
 - Self-dealing, excess benefit transactions and loans to disqualified persons
 - Tax Gap
 - Oversight on funds spent outside the U.S., including funds spent on potential terrorist activities, exempt organizations operating as foreign conduits, and FBAR requirements.

IRS Regulations, Rulings and Other Guidance

PRI Final Regulations

- Program-Related Investments Final Regulations
 - On April 21, 2016, the Service released final regulations that provide guidance to private foundations on program-related investments (PRIs).
 - Background:
 - Section 4944(a) imposes an excise tax on a private foundation that makes an investment that jeopardizes the carrying out of its exempt purposes.
 - Section 4944(c), however, provides that investments that are program-related investments (PRIs) are not jeopardizing investments.
 - PRIs are defined as investments that:
 - (1) Have the primary purpose of accomplishing one or more exempt purposes;
 - (2) Have no significant purpose in the production of income or the appreciation of property; and
 - (3) Are not used to fund electioneering or lobbying activities.
 - In addition to private foundations, these final regulations affect foundation managers who participate in the making of PRIs.

PRI Final Regulations (cont'd)

- The final regulations contain nine new examples illustrating charitable purposes that may qualify as PRIs:
 - Research and development of new drugs or vaccines to prevent a disease that predominantly affects poor individuals in developing countries where the research results are published
 - Collecting recyclable solid waste material and delivering those materials to recycling centers
 - Rebuilding a business enterprise significantly damaged by a natural disaster that employs a large number of poor individuals
 - Enabling poor individuals in developing countries to start small businesses
 - Providing efficient water management, crop cultivation, pest management, and farm management training to poor farmers
 - Developing and encouraging interests in painting, sculpture, and other art forms
 - Providing child care services in a low-income neighborhood, enabling residents to be gainfully employed

PRI Final Regulations (cont'd)

- Guiding Principles: While not part of the final regulations, the IRS posted to its website guiding principles for PRIs from the preamble to the 2012 proposed regulations:
 - An activity conducted in a foreign country furthers an exempt purpose if the same activity would further an exempt purpose if conducted in the United States;
 - The exempt purposes served by a PRI are not limited to situations involving economically disadvantaged individuals and deteriorated urban areas;
 - The recipients of PRIs need not be within a charitable class if they are the instruments for furthering an exempt purpose;
 - A potentially high rate of return does not automatically prevent an investment from qualifying as a PRI;
 - PRIs can be achieved through a variety of investments, including loans to individuals, tax-exempt organizations and for-profit organizations, and equity investments in for-profit organizations;

PRI Final Regulations (cont'd)

- Guiding Principles (cont'd):
 - A credit enhancement arrangement may qualify as a PRI;
 - A private foundation's acceptance of an equity position in conjunction with making a loan does not necessarily prevent the investment from qualifying as a PRI.
 - PRIs often involve some private benefit to one or more persons that are not part of a charitable class. This may even include the PRI recipient itself. But that is permissible so long as the private benefit is incidental to the PRI's exempt purposes.
 - Foundations may use a PRI to assume certain risks (e.g., in a deposit agreement or a guarantee) to catalyze the entry of private investment capital to further exempt purposes.

Equivalency Determination Final Regulations

- In September 2015, Treasury and the IRS issued final regulations regarding the standards for making a good faith determination (commonly referred to as an equivalency determination) that a foreign organization is a charitable organization that is not a private foundation, grants made to that foreign organization may be qualifying distributions and not taxable expenditures.
- Grantee Affidavit
 - Under the old regulations, a foundation will ordinarily be considered to have made a good faith determination if the determination is based on an affidavit of the grantee or an opinion of counsel.
 - Under the final regulations, a determination based solely on a grantee affidavit will not automatically be considered a good faith determination.
 - A grantee affidavit may be one source of information in making a good faith determination.

Equivalency Determination Final Regs (cont'd)

- The final regulations also:
 - Expand the class of advisers that may provide written advice on which foundations may ordinarily rely to include qualified practitioners who are subject to the Circular 230 standards
 - Require written advice of a qualified tax practitioner serving as the basis for a good faith determination to be “current”
 - Current means that, as of the date of distribution, the relevant law on which the advice was based has not changed and the factual information on which the advice was based is from the organization’s current or prior year
 - Do not prohibit a foundation from using written advice shared with it by another foundation in making a good faith determination if it is reasonable to do so
 - However, the written advice a foundation relies on in making its determination must be received from a qualified tax practitioner (rather than from another foundation).

Mission Investing

- Notice 2015–62
 - The notice confirms that private foundation managers may consider the relationship between a particular investment and the foundation’s charitable purpose when exercising ordinary business care and prudence in deciding whether to make the investment.
 - Background:
 - Section 4944(a)(1) imposes an excise tax on a private foundation that invests “any amount in such a manner as to jeopardize the carrying out of any of its exempt purposes.”
 - Section 4944(c) provides an exception for program related investments (PRIs), which are defined as “investments, the primary purpose of which is to accomplish one or more of the purposes described in section 170(c)(2)(B), and no significant purpose of which is the production of income or the appreciation of property.”
 - If an investment is not a PRI because a significant purpose of the investment is production of income or the appreciation of property, the investment will not be considered a jeopardizing investment if:
 - “foundation managers who have exercised ordinary business care and prudence make an investment that furthers the foundation’s charitable purposes at an expected rate of return that is less than what the foundation might obtain from an investment that is unrelated to its charitable purposes.”

IRS Private Letter Rulings

- Redomestication (PLR 201446025)
 - The IRS held that a nonprofit corporation did not have to submit a new application for an exempt determination when it moved its corporate domicile from one state to another.
 - The IRS relied on state law to conclude that redomestication was distinguishable from reincorporation:
 - The law of the non-profit corporation's original state of incorporation explicitly stated that a corporation may change its domicile and that the corporation continues without interruption after the change.
 - The law of the non-profit corporation's destination state of incorporation also provided that a change in domicile did not change the date of incorporation. Further, the law stated that the corporation would be the same corporation as the one that existed under the laws of the state in which it was previously domiciled.

IRS Private Letter Rulings (cont'd)

- Set Aside Program (PLR 201534018)
 - Private foundation's proposed set-aside program to develop innovative and dynamic educational website relating to critical scientific global issues was approved under section 4942(g)(2).
 - Set aside amount must be paid within 60-month period after first set-aside date.

- Failure to Distribute Income (TAM 201547007)
 - First-tier taxes imposed under section 4945 on private foundation's failure to distribute income for years at issue shouldn't be abated under section 4962 where foundation didn't have reasonable cause for such failure.
 - Incorrect completion of Form 990-PF by a qualified tax preparer who had all the necessary information did not constitute advice of counsel that may be relied upon when determining that reasonable cause exists for not completing a requirement of the tax code.

IRS No Rule List

- Rev-Proc. 2016-3
 - The IRS will not issue rulings or determination letters on whether an organization is or continues to be exempt under section 501(c)(3) as a private foundation or a public charity.
 - For example, whether changes in an organization’s activities or operations will affect or jeopardize the organization’s status.
 - The IRS will rule, however, on specific legal questions related to the requirements for exempt or foundation status.
 - For example, whether a specific activity furthers an organization’s exempt purpose
- Rev. Proc. 2016-5
 - The Service may issue determination letters in response to applications for recognition of exemption, as well as revocation or modification of determination letters.
 - Form 8940 is used for requests for miscellaneous determinations.

Case Law

Parks v. Commissioner

- The Tax Court held in part that a private foundation and its manager were liable for excise taxes under sections 4945(a)(1) and (2), respectively, for lobbying activities.
- Facts:
 - During its taxable years ending November 30, 1997 through 2000, the private foundation made cumulative expenditures of \$639,073 to produce and broadcast 30- and 60-second radio messages.
 - The radio messages at issue were broadcast in the weeks or months preceding a statewide election and were aimed at various ballot measures.
 - The foundation manager agreed to the making of such expenditures.

Parks v. Commissioner

- The Tax Court held that the expenditures for the radio ads were “attempts to influence legislation and/or the opinion of the general public” and therefore taxable expenditures under section 4945(d)(1).
- The ads were “direct lobbying communications” even though most did not refer to specific legislation by name.
 - “Specific legislation” for this purpose includes proposals introduced in the legislative body, including ballot measures.
- The Court held that a communication “refers to” specific legislation if it either: refers to the measure by name or, without naming it, employs terms widely used in connection with the measure or describes the content or effect of the measure.
- The Court held that most of the ads did not constitute “nonpartisan analysis, study, or research” because they did not provide “a sufficiently full and fair exposition of the pertinent facts as to permit an individual or the public to form an independent opinion or conclusion.”

Parks v. Commissioner

- The Tax Court also held that the foundation manager owed excise taxes on the radio messages that attempted to influence legislation.
 - The Court held that the foundation manager’s reliance on counsel was not sufficient to avoid the tax because counsel’s opinion was not “reasoned.”
 - A written legal opinion that “does nothing more than recite the facts and express a conclusion” is not a reasoned opinion.
- In addition, the Tax Court concluded that the application of section 4945 and the regulations thereunder to the private foundation and the foundation manager did not violate the First Amendment and that such regulations are not unconstitutionally vague.

Looking Forward

Donor Advised Funds

- IRS Statistics on Income reports growth from tax years 2006 to 2012:
 - Number of organizations sponsoring donor-advised fund (DAF) accounts increased by 19% (from 1,779 to 2,121)
 - Total number of individual DAFs increased by 56%
 - Total value of all DAFs increased by 55% from 2010 to 2012 (up to approx. \$53 billion)
- For 2012, the seven largest sponsoring organizations reported more than \$24 billion value in DAFs from over 100,000 individual funds
- Current Debate
 - Whether there should be a payout requirement for DAFs
 - If so, how much and applied over what period of time
 - Whether community foundations and large commercial funds should be subject to the same rules
 - Whether private foundations can use donations to donor advised funds to meet their 5% federal payout requirement

Social Investing: Combination of Investment and Philanthropy

- Examples:
 - PRIs
 - Mission Related Investing
 - Market-based investments that further charitable purposes, e.g. investments in green technology
 - Nonprofit/For Profit Joint Ventures
 - Benefit Corporations
 - Taxable corporate entities that include objectives such as positive impact on society, workers, the community and the environment in addition to profit as legally permissible purposes
 - Allowed under laws of about 30 states and District of Columbia
 - Pay for Success Programs/Social Impact Bonds

Social Investing: Combination of Investment and Philanthropy

- Legal Issues for Private Foundations
 - Whether investment is a jeopardizing investments
 - Whether investment counts toward annual 5% payout
 - E.g., PRIs count; MRIs do not
 - Expenditure responsibility required if invest in for-profit entities
 - Whether investment is an excess business holding
 - Self dealing transactions if invest in company that is a disqualified person or in which DPs have invested
 - Private inurement and private benefit
 - Whether excise tax on investment income applies

Pay for Success

- Innovative vehicles for financing social programs
 - Collaborations between government, nonprofit service providers, and investors to deliver preventative services to target populations
 - Proponents: programs address social problems through services that would not be delivered in programs directly funded by the government or by philanthropy
 - If programs are successful, government or philanthropy realizes savings and investors receive return of investment plus a premium or “success payment”
 - Success determined by independent evaluators based on agreed criteria

Pay for Success

- Example: Goldman Sachs/Riker's Island
 - In July 2015, Goldman Sachs Urban Investment Group made a \$9.6M loan to support the delivery of therapeutic services to 16-18 year olds incarcerated on Riker's Island, NYC
 - Goal was to reduce recidivism by 10%
 - Did not lead to reduction in recidivism
 - Goldman Sachs investment secured by \$7.2M guarantee from Bloomberg Philanthropies
 - GS losses limited to \$1.4M or 25% of investment

Questions?