AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Tax Reform Recommendations on
Charitable and Exempt Organizations Issues

Submitted to the House Committee on Ways & Means
Tax Reform Working Group on Charitable/Exempt Organizations

April 2013

Proposal: Standardize the allowable mileage rates for business expense, medical expense, moving expense and charitable contribution purposes

Present Law

A standard mileage allowance, generally determined annually, is allowed to taxpayers in determining their expenses related to employment (56.5 cents per mile beginning January 1, 2013). Further, a standard mileage allowance, also generally determined annually, is allowed to taxpayers for purposes of medical and moving expense deductions (24 cents per mile beginning January 1, 2013). When necessary, the IRS (IRS or "Service") has the authority to adjust these rates at any time (as they did in mid-year 2011 to reflect the extraordinary rise in gasoline prices). In contrast, the mileage rate allowed for charitable contribution deduction purposes is set by statute at 14 cents a mile (Code section 170(i)). Prior to 1984, the IRS had the authority to set this rate as well.

Note: Legislation (H.R. 6854 and S. 3246) was introduced in the 110th Congress to allow the IRS to once again set the charitable contribution deduction mileage rate and standardize it at the same amount as that allowed for medical and moving expenses. Separate legislation (S. 3429) also was introduced in the 110th Congress to set the charitable deduction mileage rate at 70 percent of the business mileage rate. In the 111th Congress, three bills (H.R. 345, H.R. 590, and S. 285) were introduced to set the charitable contribution mileage deduction rate at the same amount as that allowed for business expenses.

Description of Proposal

Require the IRS to set and regularly adjust, two mileage rates: one for business expenses and another for all non-business purposes (charitable, medical and moving expenses). The non-business rate should be set by the IRS at a percentage of the business rate, rounded to the nearest half cent. The business rate should be adjusted annually and possibly semi-annually in certain circumstances. The starting point would be the business rate in effect at the time of enactment.

Section 170(i) should be modified to state that a standard mileage rate, as established and regularly adjusted by the IRS, may be used. The current language regarding 14 cents per mile should be removed.

Analysis

Currently, taxpayers often need to apply at least two and sometimes three different mileage rates on a single return. The proposal would reduce these numbers to one and occasionally two rates per return. Allowing the IRS to set a fair rate for charitable contribution mileage would recognize the vital role volunteers play in our society. Linking all mileage rate allowances to a single standard and adjusting those rates at least annually would bring transparency, fairness and equity to the process. In addition, the IRS's annual calculation of these rates would be simplified.

Conclusion/Recommendation

Congress should allow the IRS once again to set the charitable contribution deduction mileage rate, which should be standardized at the same amount as that allowed for other non-business purposes (medical and moving expenses). This single rate should be set at a percentage of the business mileage allowance. All mileage allowance rates should be adjusted on an annual basis, possibly with a mid-year adjustment.

AICPA's Tax Reform Recommendations on Charitable and Exempt Organizations Issues April 2013

Proposal: Exempt from the filing requirement of section 6034(a) trusts with charitable deductions only from flow-through entities

Present Law

The AICPA continues to encourage Congress to pass legislation that simplifies the tax compliance burden of taxpayers. To further this mission, we request that Congress enact legislation that would exempt from complying with the information reporting requirements of Internal Revenue Code (IRC or "Code") section 6034(b)(1) trusts whose only charitable deductions are passed through to them from a flow-through entity (e.g., an S corporation, limited liability company (LLC), or partnership).

Section 6034(b)(1) provides that every trust that is not a split-interest trust described in section 4947(a)(2) but that is claiming a deduction under section 642(c) for the taxable year shall furnish the information with respect to the taxable year as the Secretary may by forms or regulations prescribe, including:

1. The amount of the deduction taken under section 642(c) within the year;
2. The amount paid out within the year which represents the amount for which deductions under section 642(c) have been taken in prior years;
3. The amount for which the deductions have been taken in prior years but which has not been paid out at the beginning of the year;
4. The amount paid out of principal in the current and prior years for the purposes described in section 642(c);
5. The total income of the trust within the year and the expenses attributable thereto; and
6. A balance sheet showing the assets, liabilities and net worth of the trust as of the beginning of the year.

Section 6034(b)(2)(A) provides an exception to the reporting requirement of section 6034(b)(1) for a trust for any taxable year if all the income for the year, determined under the applicable principles of the law of trusts, is required to be distributed currently to beneficiaries.

Under section 6652(c)(2)(A), a penalty is imposed for failure to file the information return required by section 6034(b). The penalty is $10 a day with a maximum of $5,000.

Trusts use Form 1041-A, U.S. Information Return Trust Accumulation of Charitable Amounts, to satisfy their reporting obligation under section 6034(b). According to the instructions, the trustee must file Form 1041-A for a trust that claims a charitable deduction or other deduction under section 642(c) unless an exception applies. The instructions provide exceptions for a trust that is required to distribute currently to the beneficiaries all the income for the tax year determined under section 643(b) and the related regulations[1]; a charitable trust described in section 4947(a)(1)[2]; and for tax years beginning after 2006, a split-interest trust described in section 4947(a)(2).[3] Section 642(c)(1) provides that a trust is allowed a deduction in computing its taxable income for any amount of the gross income, without limitation, that pursuant to the terms of the governing instrument is, during the taxable year, paid for a purpose specified in section 170(c). For a trust to claim a charitable deduction under section 642(c) for amounts of gross income that it contributes for charitable purposes, generally the governing instrument of the trust must give the trustee the authority to make charitable contributions.

Analysis

Often trusts invest in partnerships that make charitable contributions. If the partnership makes a charitable contribution from its gross income, that income is never available to the trust. For federal tax purposes, however, the trust must take into account its distributive share of the partnership's income, gain, loss, and deductions, and credits. These items include the amount of income given to charity and the corresponding deduction for that contribution. The Internal Revenue Service has recognized the trust's ability to claim a charitable deduction in this situation despite the fact that the trust's governing instrument does not authorize the trustee to make charitable contributions. See Rev. Rul. 2004-5, 2004-3 I.R.B. 295.

A similar situation arises with respect to electing small business trusts (ESBTs) that own stock in an S corporation if the S corporation makes a contribution to charity from its gross income. Treasury Reg. § 1.641(c)-1(d)(2)(ii) provides that if an ESBT is required to take into account a deduction attributable to an amount of the S corporation's gross income that is paid by the S corporation for a charitable purpose, the contribution will be deemed to be paid by the S portion of the ESBT pursuant to the terms of the trust's governing instrument within the meaning of section 642(c)(1).

For many trusts that claim a charitable deduction under section 642(c), the contribution is made by partnerships or S corporations in which the trust owns an interest, and no contributions are actually made by the trust. In these situations, we recommend that the trust be exempt from the information reporting requirements of section 6034(b) and therefore not be required to file Form 1041-A. Such trusts are not accumulating any

[1] See section 6034(b)(2)(A).

[2] See section 6034(b)(2)(B).

[3] See section 6034(a).

income that may be distributed to charity in the future. The current charitable deductions are based solely on the current income of a flow-through entity, which contributes it directly to charity, and are not from any prior year's accumulation of income by the trusts.

As discussed above, the trusts themselves never received the amounts that were given to charity and never made any direct charitable contributions. Under these circumstances, being required to file Form 1041-A places an unnecessary burden on these trusts and does not yield any additional useful information for the Internal Revenue Service. Moreover, trustees and preparers frequently are unaware of this filing requirement if the trust itself normally does not make any charitable contributions but in some years has charitable contributions passed through to it from their partnership, LLC, or S corporation investments. For these trusts, the failure to file penalty can easily run to its maximum $5,000 amount, an amount that frequently is much greater than the amount of the claimed charitable deduction. For those trustees who are aware of this filing requirement, they sometimes choose to forego claiming the deduction rather than having to file an additional tax return. We believe that an exception should be created for these trusts because charitable deductions passed through to trusts from partnerships, LLCs, or S corporations do not appear to fall within the scope and purpose of the information reporting requirement of section 6034(b).

Description of the Proposal

We suggest that an additional exception (C) be added to section 6034(b)(2) to read as follows:

> (2) Exceptions. Paragraph (1) shall not apply to a trust for any taxable year if – …
>
> (C) the trust's only deductions under section 642(c) are those attributable to charitable contributions taken into account by the trust under section 1366(a)(1) and section 702(a)(4).

Conclusion/Recommendation

We urge Congress to enact this tax simplification proposal to exempt from complying with the information reporting requirements of Internal Revenue Code section 6034(b)(1) trusts whose only charitable deductions are passed through to them from a flow-through entity (e.g., S corporation, LLC, or partnership). We look forward to working with you on this issue to achieve simplicity, effectiveness and efficiency as Congress considers this and other simplification legislation.

AICPA's Tax Reform Recommendations on Charitable and Exempt Organizations Issues April 2013

Proposal: Allow a single 6-month automatic extension for entire Form 990 series and other information, excise and income tax returns of exempt organizations

Present Law

Currently, most of the forms in the Form 990 series (e.g., Form 990, Form 990-PF, etc.) are only permitted a 3-month automatic extension on Form 8868. Exempt organizations that need additional time must then submit another request on Form 8868 and demonstrate reasonable cause in order to receive approval by the IRS for up to another 3 month extension. However, Form 990-T is currently permitted an automatic 6-month extension.

Description of Proposal

We recommend that tax-exempt organizations also be allowed a single, automatic 6-month extension of time to file all information, excise and income tax returns on Forms 990 (complete series), 4720, 5227, 6069 and 8870.

AICPA previously submitted a comment letter recommending modification to Treas. Reg. § 1.6081-9(a) on May 21, 2010 for all of the above referenced forms. In addition, it was also referenced in the AICPA's October 8, 2010 comment letter to Congress on due dates in footnote 10.

Analysis

Complying with the tax law should be straightforward so that taxpayers understand the rules and can comply with them correctly and in a cost-efficient manner. The principles of tax simplification would be advanced by one automatic extension as opposed to two extensions (one of which requires a detailed disclosure of the reason(s) why additional time is requested to file) to achieve the same result.

Good tax policy also suggests that similarly situated taxpayers should all receive fair and equitable treatment. Current law allows individuals and corporations an automatic 6-month extension of time to file their tax returns. See Treas. Reg. §§ 1.6081-3(a) and 1.6081-4(a). Tax exempt corporations, many of which are organized exclusively for religious, charitable, scientific, testing for public safety, literary or educational purposes, should not be subjected to a heightened administrative burden compared to for-profit corporations.

Allowance of an automatic 6-month extension would also promote efficiency and effectiveness of tax administration. A single automatic extension would save processing time at the IRS and eliminate the need for IRS approval of a second extension request. According to the Treasury Inspector General for Tax Administration Semiannual Report to Congress for the period ending September 30, 2009, "The IRS has experienced workforce challenges over the past few years, including recruiting, training and retaining employees, as well as an increasing number of employees who are eligible to retire." It has been our experience as practitioners that second extensions are rarely denied on returns for exempt organizations and, therefore, the underlying concern for requiring a second extension request apparently is not warranted. The small benefit derived from the second extension process, if any, does not justify the burden to the IRS and taxpayers. As such, any reduced administrative burden on the IRS should be heavily considered, since it would promote a more efficient use of its already-limited resources.

Furthermore, implementation of one automatic extension would result in an immediate cost savings for both the Federal government and taxpayers. The elimination of the second extension request, and the acceptance or denial of the request, would decrease the preparation and processing costs for all parties involved. A taxpayer cannot file an additional extension request electronically. You must submit a paper version of the fully completed and signed form. The IRS also replies to a taxpayer's request on paper and via the U.S. mail service.

One argument that might be made in opposition to the proposed revision to the regulations is that the public desires to view completed returns for exempt organizations as soon as possible after the organization's year-end. However, many government and non-government organizations require a copy of an exempt organization's Form 990 as a condition of making a grant. As such, there is an incentive not to delay filing in such instances.

In addition to working with board and audit committee schedules to review and/or approve financial statements and the Form 990, organizations with alternative investment portfolios are also at the mercy of the release of Form K-1s by investment partnerships. The final extended due date of the partnership returns is September 15. Therefore, tax-exempt investors are often waiting until September 15 to receive their Form K-1s, compute their unrelated business taxable income and assess other tax information reporting requirements. They have no choice but to file for a second extension in order to comply with the law. This is a significant issue for calendar year tax-exempt organizations.

Many of the large tax-exempt organizations need additional time to complete financial statement audits and correctly report amounts reported on investment Forms K-1. We are unaware of any evidence that requiring the filing of a second form would encourage taxpayers to file any sooner.

Conclusion/Recommendation

We propose that tax-exempt organizations be allowed an automatic 6-month extension of time to file all information, excise and income tax returns. The single extension approach would promote tax simplification, IRS efficiency, a decrease in preparation and processing costs and a reduction in the administrative burden on taxpayers.

Proposal: Reinstate retroactively and make permanent the fair market value exception under section 512(b)(13) and remove the binding contract requirement

Present Law

Prior to the passage of the Pension Protection Act of 2006 (PPA), section 512(b)(13) treated otherwise excluded rent, royalty, annuity and interest income received by an exempt organization as unrelated business income, if such income was received from a taxable or tax-exempt organization controlled by that parent organization (50 percent or more control, as computed both by direct ownership and by the constructive ownership rules of section 318). Such income was includible in the parent exempt organization's unrelated business income, and was subject to the unrelated business income tax to the extent payment of such by the controlled organization reduced its net unrelated income (or increased a net unrelated loss), determined as if the controlled entity were tax exempt.

The Pension Protection Act of 2006 modified section 512(b)(13) to provide that such payments would be treated as unrelated business income only to the extent that they exceeded the amount of any payment that would have been paid or accrued if such payment had been determined under the fair market value principles of section 482. Additionally, section 512(b)(13)(E)(i) imposed a tax addition for valuation misstatements. This provision applied only to payments made pursuant to a binding written contract in effect before December 31, 2005. Originally designed to sunset on December 31, 2007, this provision was re-extended several times, and finally sunset on December 31, 2011.

Description of Proposal

AICPA recommends that the expired provisions of section 512(b)(13) be reinstated retroactively and made permanent. We also recommend that the binding contract requirement be removed.

Analysis

Inter-organizational transactions are a normal and necessary part of modern business operations, both for nonprofit and for-profit entities alike. When conducted at arm's-length for fair value, such transactions are in line with the “prudent investment” standard which generated the original exceptions to taxation of rents, royalties, annuities and interest under section 512(b)(1). We believe the provision should be retroactively reinstated to prevent the report complexities that come with having a one-year disparate tax treatment of an ongoing contract.

Conclusion/Recommendation

As long as fair market value rules are followed, there is no genuine and substantial reason to differentiate, for purposes of these types of transactions, between related and unrelated entities. Therefore, we urge Congress to reinstate retroactively and make permanent the fair market value exception under section 512(b)(13). We also recommend the deletion of the binding contract requirement.

Proposal: Expand the exception from section 509(f)(2), which prohibits an organization from qualifying for section 509(a)(3) status if it accepted certain gifts, to be consistent with the technical change made to section 4958(c)(3)(C)

Present Law

The Pension Protection Act of 2006 (PPA) made numerous changes to the rules governing section 509(a)(3) "supporting organizations," providing for tighter, more restrictive operations by these types of charitable entities – focusing particularly on potentially abusive transactions between supporting organizations and their controllers and/or substantial contributors. Exceptions were carved out for certain transactions between supporting organizations and the organizations they support; however, the wording of these exceptions created uncertainty as to their applicability to certain types of non-charitable organizations that are afforded "supported organization" status under section 509(a)(2).

The restrictions (and exceptions) created by the PPA were these:

> A change to section 4958(c)(3) by the PPA provided in two separate subsections (sections 4958(c)(3)(A)(i)(II) and 4958(c)(3)(C)(ii)) for an exception to the general rule imposing automatic excess benefit treatment of loans paid by supporting organizations to disqualified persons and of grants, loans, compensation or other similar payment paid by supporting organizations to substantial contributors. The exception provided in each of those subsections was for "an organization described in paragraph (1), (2), or (4) of section 509(a)."
>
> New section 509(f)(2), as added by the PPA, prohibited an organization from qualifying for section 509(a)(3) "Type I" or "Type III" status if it accepted a gift from a person who directly or indirectly controlled the organization being supported – but provided "exception" language with regard to the "controlling person" restriction for "an organization" described in paragraph (1), (2), or (4) of section 509(a).

Description of Proposal

The AICPA recommends that Congress amend section 509(f)(2)(B)(i) to read (change in italics):

> 509(f)(2)(B)(i)
> a person (other than an organization described in paragraph (1), (2), or (4) of section 509(a), or any organization which is treated as described in such paragraph (2) by reason of the last sentence of section 509(a) and which is a supported organization (as defined in section 509(f)(3)) of the organization to which subparagraph (A) applies) who directly or indirectly controls, either alone

> or together with persons described in clauses (ii) and (iii), the governing body of such supported organization . . .

Analysis

Unfortunately, the PPA changes outlined above arguably could be interpreted as not being applicable to section 501(c)(4), (5), and (6) organizations that may qualify as "supported" organizations by virtue of the flush language of section 509(a). This language provides that non-charitable organizations may be supported by section 509(a)(3) organizations if their financial profile matches that of a charitable section 509(a)(2) entity. Accordingly, post-PPA, there was concern that greater restrictions under section 4958(c)(3) and 509(f)(2) could be imposed on non-charitable supported organizations, than on charitable supported entities.

The Tax Technical Corrections Act of 2007 (TCCA), as signed by President Bush on December 29, 2007, rectified one of these concerns, by making a technical change to section 4958(c)(3)(C). TCCA struck this language:

> Section 4958(c)(3)(C)(ii) EXCEPTION.—Such term shall not include any organization described in paragraph (1), (2), or (4) of section 509(a).

And substituted the following language:

> Section 4958(c)(3)(C)(ii) EXCEPTION—Such term shall not include—
>
> (I) any organization described in paragraph (1), (2), or (4) of section 509(a), and
>
> (II) any organization which is treated as described in such paragraph (2) by reason of the last sentence of section 509(a) and which is a supported organization (as defined in section 509(f)(3)) of the organization to which subparagraph (A) applies.

The amendment made by TCCA 2007 expanded the exception to the term "substantial contributor" to encompass transactions between a supported section 501(c)(4), (5) or (6) organization and its section 509(a)(3) supporting organization. This had the effect of exempting supported non-charitable organizations from the excess benefit transaction rule of section 4958(c).

Conclusion/Recommendation

An amendment is needed for section 509(f)(2). We suggest that such an amendment would reduce confusion with regard to transactions between supporting organizations and their non-charitable supported organizations.