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Tax Issues Relating to Charitable Contributions and Organizations

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Summary

The value of tax benefits for charitable contributions and organizations is estimated to be around $100 billion per year. About half of this cost arises from the deductions for charitable contributions, and about half from exemptions of earnings of non-profits.

While revisions to the treatment of charitable contributions and tax-exempt organizations that receive contributions have been made in the past few years, several issues may be considered in future legislation. Of most immediate concern are the provisions that, as a part of the "extenders," expired at the end of 2007 and may be considered for extension. Other issues that may arise reflect concerns about donor-advised funds and supporting organizations (now under study at the Treasury Department), nonprofit hospitals' provision of charity care, and educational institutions' use of growing endowments. While no current proposals are under consideration, charitable contribution floors and extensions to non-itemizers were included in the President's Advisory Panels' tax proposals and in the Congressional Budget Office's budget options study.

Most of the charitable extenders were contained in legislation first introduced in 2001. Some provisions were enacted temporarily in 2005; further provisions and extensions occurred in 2006, in the Pension Protection Act (P.L. 109-280). These extenders include an individual retirement account (IRA) rollover, liberalized treatment of certain gifts of inventory and conservation property, and two more technical provisions. (One of these technical provisions relates to the treatment of corporations that elect to be taxed as partnerships, and the other to the definition of unrelated business income of tax-exempt organizations, which is subject to tax.) These "extenders" are being considered currently in various bills.

Legislation, primarily in the Pension Protection Act, also imposed restrictions on contributions and charitable organizations to address abuses. The Act made changes relating to donor-advised funds and supporting organizations, which receive charitable contributions for further donation. That legislation also commissioned the Treasury Department to study this issue and make recommendations, including whether minimum distributions should be required. In addition, some of the same concerns about whether funds were being paid out at a high enough rate were also directed at university and college endowments, where a combination of high returns and relatively low payout rates has led to rapid growth. Issues have also been raised about whether non-profit hospitals provide enough charity care. The Senate Finance Committee has, in the past, investigated potential abuses raised by the Internal Revenue Service or reported in the media. These investigations have sometimes led to self-correction and sometimes led to legislation.

This report will be updated to reflect legislative and other changes.

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Tax Issues Relating to Charitable Contributions and Organizations

The value of tax benefits for charitable contributions and organizations is estimated to be around $100 billion per year. While revisions to the treatment of charitable contributions and tax-exempt organizations that receive these contributions have been made in the 108th and 109th Congress, a number of issues remain unresolved. Several liberalizations of tax benefits for charitable contributions, including an individual retirement account (IRA) rollover, liberalized treatment of certain gifts of inventory, and some other revisions expired at the end of 2007. These "extenders" are being considered currently in various bills. Certain issues relating to donor-advised funds and supporting organizations, which receive charitable contributions for further donation, were addressed in 2006. The legislation also included a directive to the Treasury Department to study this issue and make recommendations. In addition, some of the same concerns about whether funds were being paid out at a high enough rate were also directed at university and college endowments, where a combination of high returns and relatively low payout rates has led to rapid growth. Issues have also been raised about whether non-profit hospitals provide enough charity care.

This report reviews those issues, beginning with a discussion of current tax benefits, a review of legislative changes in the past four years, and a discussion of potential future legislative issues. It focuses on deductions for charitable contributions, and on institutions that are generally eligible for deductible charitable contributions, such as social welfare organizations, educational institutions, non-profit hospitals, and churches, along with conduits to those institutions such as private foundations, donor-advised funds, and supporting organizations.

Current Tax Benefits

The tax system provides a series of benefits for tax-exempt and charitable organizations. The most widely estimated and discussed is the deduction for charitable contributions, which is estimated in FY2008 to reduce federal revenue by about $46 billion.[1]

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[1] Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2007-2011*, JCS- 3-07, September 24, 2007. The categories for education and health are estimated separately at $7 billion and $5.2 billion respectively. Of overall charitable contributions, not all of which are deductible because they are made by non-itemizers, about a third are to religious organizations,14% are to education, 10% each to private foundations and human services, around 7% each to health and public society benefit, about 4% each to arts, culture and humanities and international, and about 2% to environment and animals,

(continued...)

Another important benefit is the exemption of earnings on assets from the income tax. As discussed below, while this benefit is difficult to estimate, it appears to be as large, in the neighborhood of $50 billion per year. For universities and colleges, these benefits are several times as large as the savings by donors from deducting charitable contributions.

Charitable Contributions

Not all tax-exempt organizations can receive tax deductible donations, but religious, educational, social welfare, health, animal protection, and similar organizations are eligible. Over the past several years, several revisions to the treatment of charitable deductions have been made, both to expand benefits and address potential abuses. Some of the provisions that expand benefits have become part of the "extenders," provisions that expire or have expired but are seen as likely to be extended or reinstated.

While charitable deductions are available to all taxpayers, individuals who take the standard deduction do not have a marginal tax incentive to give. (The standard deduction does not impose a penalty, as it is an option that can be used when it is greater than the total sum of itemized deductions.) Slightly over one-third of taxpayers itemize; about 30% deduct charitable contributions. Individuals' contributions are, in general, limited to 50% of income for most charities, but are restricted to 30% for certain non-profits, including non-operating foundations and institutions set up for the benefit of members (such as fraternal lodges). Individuals can contribute property as well as cash, and the contribution of appreciated assets has particularly beneficial treatment, since the value of most appreciated assets can be deducted without including the capital gains in income. (Some contributions of property are limited to the smaller of basis or fair market value, such as business inventory). For that reason, gifts of appreciated property are limited to 30% of income for most general charitable organizations, and to 20% for organizations with more restricted giving limits, such as non-operating private foundations. Corporate contributions are limited to 10% of taxable income. Individuals can also deduct costs of volunteering for charitable purposes, including out-of-pocket expenditures, costs of using a vehicle, and travel costs when there is no significant personal element.

The treatment of charitable contributions has been of legislative interest. A series of proposals to expand charitable benefits were made, beginning with President Bush's 2000 presidential campaign, and followed by a series of bills introduced in Congress (referred to as the Community Solutions Act and the CARE Act). The centerpiece of the initial proposal was to allow charitable deductions for non-itemizers. This provision, which was relatively costly compared to other proposals, was scaled back with ceilings and floors, and ultimately not adopted. A number of more limited proposals were considered and some were adopted, largely on a temporary basis. These temporary provisions are now part of the extenders; they expired at the end of 2007.

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[1] (...continued)
with the remaining 8% unclassified. See *Giving USA* 2006, distribution posted at [http://sforce.benevon.com/images/GivingUSA2007.htm].

Proposals and enacted legislation placing restrictions on charitable contributions were largely motivated by potential abuses, which led to some changes in the law. These included the lack of documentation of cash contributions, but largely focused on gifts of property, where the valuation of the property or even the existence of a true gift may be questioned. Broad reform proposals have also suggested restricting charitable deductions in order to make incentives more efficient, both from an economic and administrative perspective, by only allowing charitable deductions in excess of a floor.

Tax Exemption of Earnings

A less visible, but nevertheless important, benefit is that tax exemption allows organizations to accumulate assets without paying tax on earnings,[2] and estimates discussed below suggest that the revenue loss from this tax benefit is even larger than that associated with charitable contributions deductions. If charitable contributions were spent quickly, this benefit would be minimal. If contributions are held as assets and invested, tax exemption may confer significant benefits. There are several ways in which donations are invested rather than spent. Some types of active tax-exempt organizations maintain assets in the form of endowments, particularly educational institutions. Private foundations are often originally funded with a large donation and pay out a small share of assets (required to be at least 5%, however). Two other types of institutions are similar to private foundations in that they do not directly engage in activities and accumulate assets from which they make payments: supporting organizations and donor-advised funds. All of these types of asset accumulating institutions have been the subject of legislative interest.

The revenue loss of this latter benefit has likely increased substantially with the growth of educational institution endowments, particularly by some educational institutions where earnings have been substantial relative to pay-out rates. If university endowment earnings alone were subject to the corporate tax, the revenue gain is roughly estimated at over $25 billion per year for FY2007 (which ended, for most of these institutions, in June 2007). It is more than three times as large as the revenue loss for charitable donations to all educational institutions, which total around $7 billion. While the ratio of revenue cost of the asset earnings to charitable contributions is probably smaller for other types of non-profits, the cost for all non profits would probably be around $50 billion, about the same size as the cost of the charitable deduction.[3]

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[2] The unrelated business income tax, or UBIT, is imposed on business activities unrelated to the charitable purpose, but it does not apply to investment earnings such as dividends and interest.

[3] For FY2007 (ending in June of 2007) endowments of universities totaled $411 billion, and earned a return of 21.5% according to the National Association of College and University Business Officers (posted at [http://www.nacubo.org/x2376.xml]). At a 35% tax rate, this amount totals to $31 billion ($411 billion times 0.215 times 0.35). Based on the allocation of assets (about 60% to 70% in equity investments), standard shares in capital gains (60%) and shares of gains unrealized (50%), about 20% would be unrealized capital gains. The total loss would be about $25 billion ($31 billion times 0.80). The only other readily (continued...)

Congress also addressed some issues associated with tax-exempt organizations themselves. Some of this concern was directed at circumstances where tax deductible donations are made to organizations that act as conduits and do not have charitable activities. Private non-operating foundations, recipients of donations that make grants to active organizations, are required to pay out 5% of assets. Donor advised funds and supporting organizations, however, had no payout requirements. These organizations were the subject of legislative interest, not only because of concerns about payout rates, but also about the possibilities of using these organizations, which were not subject to self-dealing rules as restrictive as foundations, for private benefit. Some changes for these organizations were adopted, but major changes, such as pay-out requirements, were not in all cases; instead, Congress has authorized Treasury studies.

Although legislation has not been introduced, the tax-writing committees, especially the Senate Finance Committee, have been examining the status of some other tax-exempt organizations through hearings and studies. These include nonprofit hospitals where issues about the amount of charity care provided have been raised. The Senate Finance Committee has also focused on the growing endowments of universities and colleges. Because these educational institutions are considered active operations, there are no payout requirements. Low payout rates relative to earnings, however, have led to a rapid growth of endowments, at the same time that tuition rates have risen faster than inflation.

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[3] (...continued)
available data source of assets and earnings of specific charities is in the survey of large charitable institutions in the *Chronicle of Philanthropy* ("Special Report: Jitters Among Strong Returns," pp. 6-11, June 24, 2008). Adding the assets of institutions outside of education indicated that these large non-educational institutions had endowments about 40% the size of all educational institutions, with about three quarters attributable to foundations, implying an additional revenue cost of around $10 billion, for a total of $35 billion. This estimate is incomplete, however, as only a limited number of charities are included and not all income is from endowments. For a more comprehensive number, some estimates of passive income are included in the national income accounts. Earnings for educational institutions for FY2006, a year with comparable data, were $52 billion. Although the income concepts are not precisely the same, in calendar year 2005 (which ended approximately six months earlier) total rents, dividends and interest reported in the National Income and Product Accounts ascribed to non-profits and retained were $64 billion (Mark Ledbetter, Comparison of BEA Estimates of Personal Income with IRS Estimates of AGI, Survey of Current Business, November 2008, p. 38) and, if the share of capital gains were assumed to be the same as endowment investments, total income would be $106 billion, with the total for all nonprofits roughly twice the amount of educational institution endowment earnings. Hence, the total revenue cost would be about twice as large as the loss from exempting endowments, or about $50 billion.

Expanding Benefits for Charitable Contributions and Organizations

Legislative proposals involving expanded tax incentives for charity began in the 107th Congress with the Community Solutions Act of 2001 (H.R. 7). This bill, passed in 2001 by the House, had eight new tax provisions designed to benefit charitable giving including a capped deduction for non-itemizers. The President had proposed three of these tax provisions in his original 2001 tax proposal, but these provisions were not included in the 2001 tax cut (P.L. 107-16). Senate consideration also began in the 107th Congress with S. 1924, introduced by Senators Lieberman and Santorum, which would have provided a temporary non-itemizers deduction with a higher cap along with other provisions. The Senate Finance Committee reported this bill, the CARE Act of 2002, with a temporary non-itemizers deduction with both a floor and ceiling, but it was not considered on the floor, containing some other provisions of H.R. 7. In the 108th Congress, similar bill, S. 476, was passed by the Senate on April 9, 2003. S. 476 included some provisions that also would restrict charitable organizations, aimed at concerns about abuse. A new version of H.R. 7 passed the House in 2003. No further action occurred in that Congress.

A 109th Congress bill, S. 7, included charitable provisions. Some limited provisions, largely aimed at disasters, including the Tsunami Relief Act of 2005 (P.L. 109-1), the Katrina Emergency Relief Act of 2005 (P.L. 109-73), and the Gulf Opportunity Zone Act of 2005 (P.L. 109-135), provided additional benefits. The Senate continued to propose some of these charitable provisions along with revenue raisers, which were enacted in 2006 in The Pension Protection Act (P.L. 109-280).

This section summarizes the tax proposals liberalizing charitable contributions and briefly reviews the issues in most cases. It is followed by a section summarizing the tax proposals restricting charitable contributions and organizations. Each proposal considered in this section is identified as not adopted, temporary (adopted as a temporary provision without expectation of extension), extender (adopted with an expiration date as part of the extenders proposals), or permanent. Note that further details of provisions enacted are contained in the Joint Tax Committee's "Blue Books," that summarize legislation.[4]

Provisions Considered But Not Adopted

Four provisions were included in various proposals, but ultimately not adopted: a deduction for non-itemizers, a reduction in the foundation excise tax, an increase in the income limit on corporate deductions, and a proposal to replace the disallowance of tax-exempt status for unrelated business income in a charitable remainder trust with an excise tax.

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[4] These documents can be found on the Joint Committee's website [http://www.jct.gov/]. The legislation discussed in this report is summarized in two volumes: *General Explanation of Tax Legislation Enacted in the 108th Congress*, JCS-1-05, and *General Explanation of Tax Legislation Enacted in the 109th Congress*, JCS-1-07

Deduction for Non-Itemizers. The most significant charitable contributions proposal, in scope and revenue, considered in the last three Congresses was a deduction for non-itemizers, which was directed at encouraging charitable contributions. Under current law a taxpayer can either itemize deductions (the major deductions are charitable contributions, excess medical expenses, mortgage interest, and state and local income and property taxes) or choose the standard deduction. The standard deduction is advantageous if that amount is larger than total itemized deductions. (A limited deduction for non-itemizers was formerly available for 1981-1986, enacted as part of the Economic Recovery Tax Act of 1981 (P.L. 97-34).)

Proposals for extending the deduction to non-itemizers were considered under various proposals, in some cases including caps and floors. President Bush's initial proposal would have extended the deduction to itemizers with no restrictions that differed from those of itemizers. The first version of the House bill in the 107th Congress (2001) would have imposed a cap on the deduction, with a phased in increase to $200 for married couples and $100 for singles. The initial Lieberman-Santorum plan, S. 1924, would have provided a larger cap of $600 and $400; the Senate Finance Committee reported a version of S. 1924 (as a substitute for H.R. 7) with a temporary non-itemizers deduction with floor and a ceiling ($250/$500 for singles and $500/$1,000 for joint returns). This provision with a floor and a ceiling was also in the 108th Congress bills.

In its most recent *Budget Options* study, the Congressional Budget Office estimated that a non-itemizer's deduction with a $200/$100 cap would cost $3.4 billion over five years and $7.9 billion over ten years, while a $500/$250 cap would cost $14.7 billion and $38.7 billion respectively.[5]

While no further proposals in this area were considered in Congress in 2005, the President's advisory group proposing overall tax reform included in their plans an extension of the deduction to non-itemizers, but added a floor of 1% of income, for both itemizers and non-itemizers.[6] The Congressional Budget Office also discussed a 2% floor as a separate provision in their budget options report, indicating that such a floor would gain revenue of about $20 billion per year in the first year, $100 billion over five years, and $250 billion over ten years.[7]

The main objective of this extension of the deduction to non-itemizers was to increase charitable giving. Charitable provisions were, however, considered after the 2001 tax cuts which involved considerable revenue costs. Caps were seen as a means to constrain the revenue loss. At the same time, while the deduction for non-itemizers may increase giving, its effects would be limited because of the cap, and the dollars of charitable giving induced per dollar of revenue loss would be smaller, particularly with a small cap. In addition, the provision would increase complexity for taxpayers who do not itemize.

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[5] Congressional Budget Office, *Budget Options*, February 2007, p. 273.

[6] President's Advisory Panel on Federal Tax Reform, *Simple, Fair and Pro-Growth,: Proposals to Fix America's Tax System*, Washington, DC, U.S. Government Printing Office, November 2005.

[7] Congressional Budget Office, *Budget Options*, February 2007, p. 272.

Floors also limit the revenue cost, but increase effectiveness per dollar of revenue lost (relative to a provision without a floor) and simplify the tax code because taxpayers with small amounts of contributions would not qualify. Even without a cap, the deduction may not induce additional giving as large as the revenue loss because the responsiveness of taxpayers, particularly lower and moderate income taxpayers, to incentives may be small.[8]

Reducing the Foundation Investment Income Excise Tax. Current law imposes a 1% tax on investment income of foundations, and an additional 1% if the foundation does not make a certain minimum distribution (based on average distribution rate over the previous five years), or has been subject to a tax for failure to distribute in the previous five years. The House considered several bills that would have eliminated the extra 1% tax. This provision accounted for a $2.3 billion revenue cost over 10 years when last considered in 2003. The proposal was not included in the Senate bills under consideration at this time.

Private foundations, whose contributors (or their families) retain the right to direct the distribution of funds, have always been subject to greater scrutiny, in part because of the possibility of the donor (or family) obtaining a private benefit. Foundations are required to distribute 5% of their assets each year (or pay a penalty), but the tax is credited against that distribution.

If the foundation is just making the minimum distribution, every dollar of tax reduction should be funneled into distributions because the tax is credited against the deduction. Since the tax and the actual distribution sum to a fixed amount, a fall in the tax will result in a rise in the amount distributed to other organizations. Moreover, the moving average rule which imposes the additional 1% tax if the foundation does not distribute at the average rate of the last five years discourages a large contribution in a particular year because it increases the hurdle for future avoidance of the tax. The reduction in the investment tax should also make private foundations more attractive to givers in general, although that increased attractiveness might in part induce more contributions, and in part replace contributions that might have gone to other charities. The effects should be small, however, because the tax is small.

Proponents of reducing the tax also argued that it should be reduced because it brings in revenue that is in excess of IRS audit costs, which they indicate was the original purpose of the tax (which was introduced in 1969). The revenue stream from this tax has, however, been quite variable recently because it is heavily affected by the stock market. In any case, a reading of the legislative history indicates that while the Senate characterized the tax as an audit fee, the House referred more generally to the notion that private foundations should bear part of the cost of government generally because of their ability to pay (as well as viewing it in part as a user fee), and both objectives were cited in the bill's final explanation. It was

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[8] See CRS Report RL31108, *Economic Analysis of the Charitable Contribution Deduction for Non-Itemizers* by Jane G. Gravelle. The effects of alternative approaches on revenues and charitable giving were also addressed in Congressional Budget Office, *Effects of Allowing Nonitemizers to Deduct Charitable Contributions,* December 2002.

reduced twice (in 1978 and 1984) based on the argument regarding costs of audit versus revenue.

Another argument made for eliminating the additional tax is the additional complication arising from it. At the same time, simplification does not require reduction in the tax; it could be converted to a larger flat fee.

The 2003 House proposal added a new provision that limited the counting of administrative costs as part of a foundation's minimum distribution requirement. Foundations are required to make a minimum distribution of 5%, but that 5% can currently include administrative costs (which currently have to be "reasonable"). As originally introduced earlier in 2003, the provision would have disallowed any administrative costs, but the proposal as reported allowed deductions for most administrative costs, with some exceptions.

The provisions affecting foundations were not adopted.[9] Moreover, concerns about abuse ultimately led to some increases in taxes and penalties including those on foundations, which are described below.

Raising the Corporate Charitable Deductions Cap. Under current law corporations can deduct charitable contributions of up to 10% of income; the 2003 House proposals would have gradually raised the cap to 20% (by one percentage point each year beginning in 2004, reaching 15% in 2008-11, and 20% thereafter). The initial (107th Congress) provision would have raised the limit to 15%. This provision was not in the Senate bill. This provision is relatively small, and most corporate giving already falls well under the cap; the average giving is less than 2% of income.

Some question the appropriateness of corporate charity, since shareholders could make their own decisions about charitable giving. Allowing the deduction at the firm level is, however, more beneficial to the donor since both the corporate and individual taxes are eliminated. In some views, charitable giving by corporations is another management perk that might be excessive because of monitoring problems by shareholders (this problem is also called an agency cost problem). Others argue that corporations should be encouraged to give to charity and to be socially responsible. Economists have studied models in which charitable giving is part of the firm's profit maximizing behavior (e.g., by gaining the firm good will). Evidence on the effectiveness of the deduction is mixed, with time series studies showing a positive effect and cross section results not finding an effect.[10]

Unrelated Business Income of Charitable Remainder Trusts. Current law provides tax deductions for some portion of a trust and income tax exemption on the earnings, if a remainder of the assets is left to charity (while paying income to a

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[9] CRS Report RS21603, *Minimum Distribution Requirement for Private Foundations: Proposal to Disallow Administrative Costs*, by Jane G. Gravelle.

[10] See James R. Boatsman and Sanjay Gupta, "Taxes and Corporate Charity: Empirical Evidence from Micro-Level Panel Data," *National Tax Journal*, Vol. 49, June 1996, pp. 193-213.

non-charitable donee, usually a spouse or other relative during an interim period). The trust's income is, however, no longer exempt from tax if the trust has unrelated business income. There have been congressional proposals to liberalize the rule by providing for a 100% excise tax on any unrelated business income rather than loss of all tax exemption. This provision would have accounted for a negligible cost.

Disaster Provisions Enacted on a Temporary Basis

Several provisions were enacted in 2005 in response to disasters. The Tsunami Relief Act of 2005, P. L. 109-1 allowed contributions made in January 2005 to be treated as made in the previous year (and therefore deductible on 2004 tax returns) to encourage giving for relief from the Tsunami that struck in 2004. The Hurricane Katrina Emergency Relief Act of 2005 adopted several provisions, effective through 2005, to encourage giving to Katrina victims. It allowed unlimited cash contributions for individuals (normally restricted to 50% of income). It also allowed unlimited contributions for corporations (normally restricted to 10% of taxable income) if contributions were made to aid Katrina victims. Charitable contributions made after the disaster were not subject to the phase out of itemized deductions. Mileage rates for deducting costs of using a vehicle for charitable purposes to aid Katrina victims were increased from 14 cents to 70% of the business rate of 48.5 cents. Reimbursements for these costs in excess of the mileage allowance were not included in income if the activity was for the aid of Katrina victims. The Gulf Opportunity Zone Act P. L. 109-135 extended the benefits of higher limits to contributions to Hurricanes Rita and Wilma.

Provisions Now Part of the Extenders

Seven provisions were enacted with expiration dates; they expired at the end of 2007, although one has since been extended. The extended provision relates to donation of conservation property. The remaining six are now included in various bills to authorize them for an additional year. They include the IRA rollover provision, three provisions relating to donations of business inventory, a provision regarding the effect of a charitable donation on the basis of stock of small corporations that elect to be taxed as partnerships, and a provision eliminating the unrelated business income tax on arms-length rental payments to tax-exempt organizations from a related entity.

Contributions of Conservation Property. Another important set of provisions, originated in the Senate, expanded benefits for contributions for conservation purposes by lifting the cap on contributions as a percent of income. Gifts of appreciated property are deductible at the fair market value, but, for individuals, have lower limits (30% of income) than ordinary gifts such as cash (50% of income). The Pension Protection Act (P.L. 109-280) increased the limit for appreciated property contributed for conservation purposes to 50% for individuals. The provision increased the limit to 100% for farmers and ranchers, including individuals and for corporations that are not publicly traded. To qualify, land used or available to be used for agricultural or livestock production must remain available for such purposes. This provision expired at the end of 2007, but has recently been extended for an additional two years in the Food, Conservation, and Energy Act of 2008, P.L. 110-234. As noted above, lower income limits for gifts of appreciated

property reflect concerns about the overstatement of fair market value and the deduction of amounts that have not been included in income.

IRA Rollover Provision. All of the proposed charitable contribution proposals considered in Congress included a provision to allow tax free distributions from individual retirement accounts to charities by individuals aged 70 and ½ or older. This provision was adopted on a temporary basis in the Pension Protection Act in 2006 but expired at the end of 2007. The treatment benefits non-itemizers, who would not otherwise be able to take a deduction, although in the President's original proposals nonitemizers would be allowed a deduction in any case.

While this treatment may appear no different, for itemizers, from simply including the amounts in adjusted gross income and then deducting them as itemized deductions, it can provide several types of benefits even to those who itemize. This treatment reduces adjusted gross income which can trigger a variety of phase-outs and phase-ins, including the phase-in of taxation of Social Security benefits. There are also income limits on charitable contributions: individuals can contribute no more than 50% of income in cash and no more than 30% in appreciated property. Since IRAs tend to be held by higher income individuals, the taxpayers might be somewhat more sensitive to the incentive to give; however, the law does not specify why this particular group of taxpayers was targeted for an expansion of charitable giving provisions. This provision was adopted in P.L. 109-280 with a $100,000 annual limit and expired at the end of 2007. It was projected to cost $238 million in the first year, and $856 million over ten years.

Extending the Deduction for Food Inventory to all Businesses. Corporations that donate inventory to charity in general get a deduction for the cost (not the market value). A special rule allows businesses paying the corporate tax to also exclude half the appreciation (half the difference between market value and cost of production) if the inventory is given to an organization that directly passes it on to the ill, the needy, or infants, as long as the total deduction is no more than twice the cost. An important category of donations is food. There have been disputes between taxpayers and the IRS about how to measure the fair market value of food.[11] The charitable contributions proposals would have allowed unincorporated businesses (or businesses that are incorporated but do not pay the corporate tax) the additional deduction, and the fair market value of wholesome food would be considered the price at which the firm is currently selling the item (or sold it in the past), although this deduction would be limited to the corporate percentage cap on deductions in general. This provision's cost was relatively small.

The provision's objective was to create more equity among different types of taxpayers and resolve disputes (largely in the taxpayer's favor). However, as with the deduction of appreciated property, these rules allow firms to deduct amounts that have not been included in income. While the provision is limited by allowing only one half the appreciation, these products, if sold, would be taxed at full rates (rather than the lower rates imposed on individual capital gains). In addition, as with gifts

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[11] See CRS Report RL31097, *Charitable Contributions for Food Inventory: Proposals for Change*, by Pamela Jackson.

of capital gain property, an important concern is the potential overstatement of market value. Firms may only be able to sell donated inventory at a much lower price because the product is damaged in appearance, is older, or has other characteristics that would require deep discounting to sell. Moreover, a firm with market power may not wish to sell all of its inventory because increasing supply will drive the price down more for a sale than a donation. It is possible that a provision that is extended to non-corporate businesses, which are smaller and more numerous, will be more difficult to monitor for compliance.

For inventory that cannot be practically sold, the barrier to a donation by the firm is the extra costs encountered in distributing the product. Thus, there is a tradeoff between creating an incentive and providing a windfall for the firm.

The Katrina Emergency Relief Act of 2005 (P.L. 109-73) provided treatment to unincorporated firms (not to exceed 10% of business income) through 2005 but did not make the other changes. The Pension Protection Act of 2006 (P.L. 109-280) extended the provision through 2007.

Contributions of Scientific and Computer Property. Certain special treatment (similar to that for food inventory) is allowed for certain scientific property used for research and for contributions of computer technology and equipment, provided the property is constructed by the taxpayer. In concrete terms, this rule requires that no more than 50% of the cost is due to parts purchased elsewhere. The issues surrounding this provision are the same as those related to other contributions of inventory, such as food inventory. This provision expired in 2003. The proposals would have allowed property assembled, as well as constructed, to be eligible and make the provision permanent, although the Senate proposal involved an extension. The Working Families Tax Relief Act of 2004 (P.L. 108-311) extended the existing provisions through 2005 and The Tax Relief and Health Care (P.L. 109-432) extended the provision, including the expansion to assembled property, through 2007.

Contributions of Book Inventory. A provision that originated in the Senate extended the treatment of food inventories to book inventories donated to public elementary and secondary schools. As with all contributions of property, valuation may be an issue. Book publishers who have printed too many books may only be able to sell them at a discount, and perhaps a potentially deep one. This provision was enacted in the Katrina Emergency Relief Act of 2005 (P.L. 109-73) through 2005. The Pension Protection Act of 2006 (P.L. 109-280) extended the provision through 2007.

Basis of S Corporation Stock for Charitable Contributions. Under current law, a shareholder in a Subchapter S corporation (a corporation treated as a partnership) is allowed to deduct his or her pro rata share of any corporate contribution. At the same time, the taxpayer must decrease the basis of stock by that amount (which is a way of reflecting the effect on the shareholder's asset position). The Congressional proposals on charitable contributions provided that the taxpayer would not have to reduce basis in the stock to the extent a deduction is taken in excess of adjusted basis of the donated property (e.g., cost). This provision appears to be consistent with allowing a deduction for the market value of appreciated

property without including the appreciation in income (a special benefit generally available to taxpayers). This provision's cost was relatively small. The Pension Protection Act of 2006 (P.L. 109-280) included this provision effective through 2007.

Unrelated Business Income: Related Party Payments. Charities are subject to a tax on unrelated business income. Rents, royalties and annuities are excluded from income subject to the tax except when received by a majority owned subsidiary. Among provisions included in the 108th Congress version of charity proposals was one to exclude certain items (such as rent) received by a subsidiary from a tax on unrelated business income except for the excess over an arms-length price. As with other provisions, however, the determination of arms-length rents is not always straightforward when there are not closely comparable properties. This provision was adopted in the Pension Protection Act (P.L. 109-280), and applies to payments through 2007.

Permanent Reduction in Excise Tax Reduction for Blood Collector Organizations

The Pension Protection Act of 2006 (P.L. 109-280) included a provision exempting qualified blood collectors from a variety of excise taxes, including communications taxes and taxes relating to fuels and vehicles. This provision is directed at the Red Cross.

Recent Restrictions on Charitable Donations and Organizations

Congress has considered many provisions over the last three Congresses aimed at preventing potential abuse, with many problematic areas identified by the Internal Revenue Service.[12] The Senate Finance Committee, and Senator Grassley, currently the ranking member, have investigated many compliance issues.[13] In 2004 and 2005, the Senate Finance Committee held hearings on the subject. Also, early in 2005, the Joint Committee on Taxation published an study on options to improve tax compliance that included a number of provisions relating to charitable contributions and tax-exempt organizations.[14]

The concerns expressed in these hearings and studies focused on potential abuses of charitable organizations, on the valuation of gifts of property, and on certain types of organizations, including donor-advised funds and supporting organizations. These two types of organizations, like private foundations, permit

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[12] See, for example, testimony of Mark Everson, Commissioner of Internal Revenue, Statement on Exempt Organizations, Enforcement Problems, Accomplishments and Future Directions before the Senate Finance Committee, April 5, 2005: [http://finance.senate.gov/hearings/testimony/2005test/metest040505.pdf].

[13] Summary of Senator Chuck Grassley's Non-Profit Oversight, November 20, 2007: [http://www.senate.gov/%7Efinance/press/Gpress/2007/prg112007a.pdf].

[14] Joint Committee on Taxation, *Options to Improve Tax Compliance and Reform Tax Expenditures*. JCS-2-05, January 27, 2005, posted at [http://www.jct.gov/s-2-05.pdf].

contributions to build up an account without necessarily making a contribution. Private foundations, however, are subject to a 5% pay-out requirement and a number of special restrictions to prevent funds from being used for the benefit of the donor. Donor-advised funds are funds where the donor contributes to an account in an institution and the institution subsequently makes contributions, advised by the donor. Supporting organizations do not have a direct charitable purpose, but support organizations that do.[15]

More broad ranging proposals to make the charitable contributions deduction more effective and less subject to claims of small undocumented deductions would have introduced a floor. Earlier proposals associated with expansions of the deductions to non-itemizers proposed dollar floors, but these proposals tended to focus on floors as a percent of income. The President's Advisory Panel on Tax Reform proposed a floor equal to 1% of income.[16] The Congressional Budget Office included a budget option for a floor of 2%,[17] with an estimated revenue gain of about $20 billion in the first year, $99 billion over five years, and $250 billion over ten years.

Some changes were enacted in 2003 and 2004, but most of the restrictive provisions that were adjusted were part of the Pension Protection Act of 2006.

Restrictions on Charitable Contributions

A series of restrictions on charitable donations, aimed at reducing abuse, were adopted. Most of these provisions related to gifts of appreciated property, where the gift is deducted at fair market value. These gifts account for about 25% of all donations, and for much larger shares of donations of higher income taxpayers. For taxpayers with incomes above $10 million, gifts of property account for 50% of contributions. Taxpayers with incomes above $1 million account for 18% of cash gifts, but 40% of property gifts.[18] This provision is especially beneficial to the donor because a deduction is allowed for the full value, while the appreciation is not taxed. While the valuation of contributions such as publicly traded stock is straightforward, the valuation of gifts where value is not easily assigned presents some issues for tax compliance. If the taxpayer can value donated property at an excessive value, it is even possible to benefit privately from making a contribution rather than by selling the property.

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[15] Issues surrounding supporting organizations and donor-advised funds, as well as gifts of appreciated property, are discussed in the testimony of Jane G. Gravelle, on Charities and Charitable Giving: Proposals for Reform, before the Senate Finance Committee, April 5, 2005, posted at:
[http://finance.senate.gov/hearings/testimony/2005test/jgtest040505.pdf]

[16] President's Advisory Panel on Federal Tax Reform, *Simple, Fair and Pro-Growth,: Proposals to Fix America's Tax System*, Washington, DC, U.S. Government Printing Office, November 2005.

[17] Congressional Budget Office, *Budget Options*, February 2007.

[18] These data are reported in the testimony of Jane G. Gravelle, on *Charities and Charitable Giving: Proposals for Reform*, before the Senate Finance Committee, April 5, 2005, posted at: [http://finance.senate.gov/hearings/testimony/2005test/jgtest040505.pdf].

The President's Advisory Commission on Tax Reform proposed in 2005 that individuals be allowed to sell appreciated property and donate the proceeds without paying the capital gains tax, to address the valuation problem.[19]

During the debate on the treatment of gifts of appreciated property, some broad changes were discussed. For example, the Joint Committee on Taxation presented an option in its study to allow only the basis to be deducted for gifts of property that were not publicly traded. A Senate staff discussion paper, among a broad array of options discussed, considered "baseball arbitration," where the court can only find for the taxpayer's original value or the IRS value, which would create an incentive to limit any overstatement of value.[20] Although these provisions were not adopted, a number of changes were, as detailed below.

Vehicle Donations and Gifts of Intellectual Property. Growing concerns about the abuse of donations of used vehicles and of patents and other intellectual property led to several revisions in the American Jobs Creation Act of 2004 (P. L. 108-357). According to IRS data, in 2003, $2.3 billion of deductions associated with vehicles was deducted, for those taxpayers who had non-cash contributions of $500 or more.[21] Often charities resold vehicles at a much smaller value than the value deducted by the taxpayer.[22] The revision required that, for vehicles with a value of $500 or more, the deduction is restricted to the value of resale, if the vehicle is resold rather than used or refurbished by the charity. The act also extended to corporations the requirement of an appraisal for a donation of property (other than readily valued property such as cash, inventory, and publicly traded securities) of $5,000. This appraisal is not required in the case of resale of a vehicle by an organization. It also required appraisals to be attached to tax returns for gifts valued at $500,000 or more. Finally the law restricted the donation of intellectual property, which could be valued at fair market value, to the lesser of basis (roughly cost of developing or purchasing) or market value.

Contributions of Historical Conservation Easements. As a general rule, a taxpayer cannot take a deduction for a partial interest in a property. However, gifts of conservation or historical easements (where the taxpayer restricts the use of property) may be made. Their value is the reduction in the value of the property due to the easement. One concern that arose was that taxpayers were making gifts of easements on historical facades (the front of the building), which involve an agreement not to change the facade, when the regulations in the historical district

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[19] President's Advisory Panel on Federal Tax Reform, *Simple, Fair and Pro-Growth,: Proposals to Fix America's Tax System*, Washington, DC, U.S. Government Printing Office, November 2005.

[20] For a discussion, see the testimony of Jane G. Gravelle, on Charities and Charitable Giving: Proposals for Reform, before the Senate Finance Committee, April 5, 2005, posted at: [http://finance.senate.gov/hearings/testimony/2005test/jgtest040505.pdf].

[21] Janette Wilson and Michael Strudler, "Individual Non-Cash Charitable Contributions 2003," Internal Revenue Service, *Statistics of Income Bulletin*, Spring 2006, p. 59.

[22] See, for example, the report by the GAO, *Vehicle Donation: Benefits to Charities and Donors but Limited Program Oversight*, GAO-04-73, November 2003, at: [http://www.gao.gov/new.items/d0473.pdf}.

already imposed this restriction. Thus there could be no effect on property values. A provision in the Pension Protection Act required these easement to be limited to buildings but to apply to the entire exterior (not just the facade), and that an appraisal be supplied.

Contributions of Taxidermy Property. Press reports suggested that individuals involved in big game hunting were receiving deductions for contributing their mounted trophies at inflated prices which were often resold at a lower price.[23] In addition to the revenue effects, concern was expressed by environmental and animal rights groups. The Pension Protection Act restricted the deduction to the cost of mounting the trophy; thus, cost does not include the cost of hunting trips.

Recapture of Tax Benefit if Not Used for Exempt Purpose. The Pension Protection Act requires individuals who give gifts of appreciated property to be subject to a recapture tax if the property is not used by the organization for its exempt purposes and is sold within three years. If the property is sold in the same year, the donor generally deducts basis (cost); if sold after that year, the donor must include in income the difference between fair market value claimed and the basis.

Deductions for Contributions of Clothing and Household Items. Contributions of used clothing and household items present difficulties because these items are difficult and time intensive to value and audit. They are significant in value, however. In 2003, these contributions were estimated at $8.6 billion for those with $500 or more of non-cash contributions; clothing accounted for two thirds of the total.[24] The amounts would be larger if taxpayers with contributions of less than $500 in cash were included. The Pension Protection Act disallows the deduction for items not in good used condition or better and provides the Internal Revenue Service with broad authority to disallow deductions. Items valued more than $500 may be deducted if not in good used condition or better if accompanied by an appraisal. Household items do not include items such food, art, antiques, jewels and gems, and collections.

Recordkeeping Requirements. The Pension Protection Act changed the rule that allowed substantiation of small cash contributions by a written record or log. All cash contributions must be substantiated by a bank record (e.g., cancelled check) or receipt from the organization.

Contributions of Fractional Interests. Taxpayers could deduct contributions of fractional interests in art although they could not deduct a contribution of a future right to the art.[25] For example the taxpayer could contribute

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[23] See Zachary A. Goldfarb, "Pension Bill Also Curbs Hunter's Breaks," *Washington Post*, August 5, 2006.

[24] Janette Wilson and Michael Strudler, "Individual Non-Cash Charitable Contributions 2003," Internal Revenue Service, *Statistics of Income Bulletin*, Spring 2006, p.59.

[25] The magnitude of these donations is difficult to determine as is the degree of potential abuse. Certain museums that had wealthy patrons using this process could lose significant donations, although these art works may not necessarily be exhibited constantly because of

(continued...)

a 10% interest in an art work to a museum, and receive a deduction for 10% of the value of the art. The museum would have the right to possess the art for 10% of the year. There were several concerns about this tax treatment. First, a court decision (Winokur v. Commissioner) settled in 1988 found that physical possession was not required to make a fractional interest donation, only the right to physical possession.[26] The Internal Revenue Service challenged this case, but the court found for the taxpayer. As a result, individuals could keep art work in their possession, perhaps through their lifetimes, or even pass the property on to their heirs, while still securing a charitable contribution deduction. The second is a concern that the possession or display of the art by the museum itself enhances the market value of the work, effectively increasing the value of the art work, and the value of future deductions or sales compared to an outright gift. Another set of issues relates to estate taxes. Estate taxes can be reduced by a reduction in value due to minority discounts — the view taken by the courts that an ownership of a minority interest in an asset loses some value because of lack of control. The minority ownership does not, however, affect the value of the charitable deduction for income or estate tax purposes. The Pension Protection Act requires physical possession by the donee, requires the gift to be completed within 10 years or at the donor's death, whichever comes first, disallows fractional donation of a property that is not wholly owned by the donor, or the donor and donee for later gifts, (the Secretary of the Treasury can make an exception if multiple owners donate similar fractional shares), and requires that subsequent fractional shares are limited to market value at the time of the original donation. If these restrictions are not met the tax savings from the deduction are recaptured with interest and a 10% penalty.

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[25] (...continued)
fractional ownership. According to a news report, the San Francisco Museum of Modern Art received 48% of donations in fractional giving in the fiscal year ending in 2001, although the share fell to 10% the next year and has recently climbed to 20% (See Sarah Duxbury, "SFMOMA Turns 'Timeshare' Gifts into an Art Form," *San Francisco Business Times*, August 19, 2005). In general, most discussions of fractional giving in the news seem to suggest that having the donor keep the art is not uncommon. (See Rachel Emma Silverman, "Joint Custody for your Monet," *Wall Street Journal Online*, July 7, 2007). A law journal article, in discussing the proposal to require physical possession stated: "This would effectively put an end to fractional gifts of large sculptures that are difficult and expensive to move every year. It will also substantially curtail fractional gifts of paintings since it is usually not the best idea to constantly move a fragile painting every year." This discussion also suggests that physical possession is an important issue. See Ralph E. Lerner, "Fractional Gifts of Art." *New York Law Journal*, April 24, 2006. A New York Times article stated "in practice, many museums have waived their right to possess pieces at all except when they needed them for exhibitions."Jeremy Kahn, "Museums Fear Tax Law Changes on Some Donations," *New York Times*, September 13, 2006.

[26] Winokur v. Commissioner, 90 T.C. 733 (1988). James Winokur contributed fractional interests in paintings to the Carnegie Museum, and the museum had a right to possess the paintings but never did. This case is summarized in Marylynne Pitz, "Fractional Donations Require Close Look at the Law," *Pittsburgh Post-Gazette*, July 24, 2005: [http://www.postgazette.com/pg/05205/541620.stm].

Penalties on Overstatements of Valuations. This provision lowered the thresholds for imposing penalties for overstatements of value for the income tax and understatement for the estate tax. It also established a separate penalty structure for appraisers.

Restrictions on Tax-Exempt Organizations

A few provisions were enacted during the 108th Congress that applied to tax-exempt organizations, but most provisions were enacted in the 109th Congress, primarily in the Pension Protection Act in 2006. Some of these provisions affect organizations that are tax exempt but are not charitable organizations.

Terrorist Activities. The Military Family Tax Relief Act of 2003 (P.L. 108-121) provided for automatic suspension of the tax-exempt status of organizations placed on the designated list of terrorist organizations or supporters of terrorism. Normally, suspension of tax-exempt status requires or permits administrative and judicial proceedings.

Leasing Activities. In a provision not directly affecting contributions or tax-exempt status, but which nevertheless might have consequences for tax-exempt organizations, the American Jobs Creation Act of 2004 also restricted the ability of parties leasing arrangements to obtain favorable tax treatment.[27]

Penalties for Tax-Exempt Organizations in Prohibited Tax Shelters. Some tax shelter operations require participation of a tax-exempt entity. This provision imposed penalties on exempt organizations that are a party in a prohibited tax shelter transaction. It was enacted in the Tax Increase Prevention and Reconciliation Act (P.L. 109-222) in 2006.

Life Insurance. Investments in life insurance are subject to beneficial tax treatment, including exemptions when assets are paid at death and deferral of tax on investment earnings. State laws restrict the holding of an interest in life insurance if there is no insurable interest (e.g., a relationship with the insured). Some states exempt charities from the insurable interest and some allow insurable interests for private investors if there is also a charitable organization involved. The Pension Protection Act does not directly affect these relationships but requires temporary reporting on life insurance arrangements by exempt organizations (for two years) and mandates a study of this issue by the Treasury Department.

Penalties and Penalty Taxes. A series of penalties applies to certain actions of charitable and tax-exempt organizations. The most punitive penalty for an inappropriate action, in general, is to revoke the exempt status. There are a series of intermediate sanctions that generally impose monetary penalties. An excess benefit tax applies to transactions of charitable welfare organizations (other than private foundations) and social welfare organizations. Private foundations are

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[27] A discussion of this issue can be found in CRS Report RL32479, *Tax Implications of SILOs, QTEs, and Other Leasing Transactions with Tax-Exempt Entities*, by Maxim Shvedov.

subject to taxes and/or penalties for self-dealing, failure to distribute income, on excess business holdings, for investments that jeopardize the charitable purposes, and for taxable expenditures (such as lobbying or making open-ended grants to institutions other than charities). The Pension Protection Act increased those taxes and penalties.

Credit Counseling Agencies. Non-profit credit counseling agencies obtained tax-exempt status because their purpose was largely to educate and counsel consumers, and perhaps offer some tailored debt management plans as well. A rapid growth of tax-exempt credit counseling agencies occurred in the 1990s. Press reports and investigations suggested that there was widespread abuse and that these new firms were not primarily being used for educational purposes but were used to enroll individuals into payment plans. The Internal Revenue Service performed audits and revoked tax-exempt status for some agencies. The Pension Protection Act established a series of standards and requirements for exempt credit counseling agencies and treated debt management plans as an unrelated business, with earnings subject to the unrelated business income tax.

Expanding the Base for Imposing Foundation Excise Taxes. As discussed above, foundations are subject to excise taxes on investment income. The Pension Protection Act expanded the base to include additional types of income — such as income from financial contracts, annuities, and certain capital gains.

Defining Conventions or Association of Churches. A convention or association of churches is not required to file an information return and is subject to provisions generally applicable to churches. The Pension Protection Act specified that a convention or association of churches would not fail to qualify because there are individual members.

Information Reporting: Organizations Not Filing Annual Returns. While exempt organizations are required generally to file information returns, certain organizations are exempt (these include small organizations, certain religious organizations and certain government related organizations). The Pension Protection Act, requires these organizations to report contact information to the Internal Revenue Service (i.e., organizational title, address).

Disclosure to State Officials. The Secretary of the Treasury is required to notify the appropriate State officer of a refusal to recognize an organization as a charitable one that may receive tax deductible contributions, revocation of that status, and the mailing of a notice of deficiency for certain taxes. Returns and records relating to this disclosure must be made available for inspection. This provision in the Pension Protection Act revises the rules for disclosure of tax information to state authorities, including the disclosure, upon request, of a notice of proposed refusal to recognize, revoke, or issue a deficiency, names and addresses of applicants, and associated returns.

Disclosure of the Unrelated Business Income Tax Return. Organizations are required to make information and application materials available for public inspection. The Pension Protection Act requires disclosure to be applied to the return reporting unrelated business income.

Donor-Advised Funds and Supporting Organizations. The Pension Protection Act authorized Treasury Department studies of donor advised funds and supporting organizations and made other changes to their status.[28] Donor advised funds are funds where donors make contributions and the institution holding the accounts makes contributions to charitable organizations with the advice of the donor. While the donor has no legal control, in practice the donor's wishes are likely to be respected. Supporting organizations do not actively engage in charitable activities but support organizations that do by contributing funds to them. Supporting organizations fall into three types: Type I controlled by the charitable organizations, Type II, controlled by the same entity controlling the charitable organization and Type III, related to the charitable organization. Type III organizations may support many charitable organizations.

These types of organizations had many features in common with private foundations, but were not subject to self dealing rules and other restrictions (meant to prevent the donor from receiving a private benefit) or payout requires (meant to keep the organization from accumulating funds without paying out some amount for charitable purposes). There was some evidence that abuses were occurring and that, in some cases, little was being paid out. In addition to the mandated studies, other changes, including the following, were made.

Donor-advised funds eligible for charitable contributions were specifically defined in the law. They were prohibited from providing benefits to the donors, they were required to have a governance structure if grants were made to individuals (such as a scholarship fund), and contributions of closely held businesses had to be sold within a short period of time.

Supporting organizations must indicate which type they are and certain Type III organizations will eventually be subject to a minimum payout (with the Treasury Secretary making such a determination through issuance of regulations). In August 2007, the Treasury issued proposed regulations and invited comment, indicating the same minimum distribution rule applying to foundations (5% of assets) is expected to be applied.[29]

In general, the Pension Protection Act prohibits supporting organizations from making grants or loans, or paying compensation, to substantial contributors. Supporting organizations cannot receive contributions from persons who control the organization, and from private foundations if the supporting organization is

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[28] Issues surrounding supporting organizations and donor-advised funds are discussed in the testimony of Jane G. Gravelle, on Charities and Charitable Giving: Proposals for Reform, before the Senate Finance Committee, April 5, 2005, posted at: [http://finance.senate.gov/hearings/testimony/2005test/jgtest040505.pdf]. See also Nick G. Tarlson, "Donor-Advised Funds Preparing for Closer Scrutiny," *Journal of Accountancy Online*, January 2008 [http://www.aicpa.org/pubs/jofa/jan2008/donor_advised_funds.htm].

[29] The proposed regulation can be found at: [http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/E7-14925.pdf].

controlled by significant persons at the foundation. They are not eligible for the rollover treatment for individual retirement accounts (IRAs). Type III organizations must also file additional information and cannot support foreign non-profits.

Current Issues Surrounding Charitable Deductions and Organizations

As indicated in the discussion above, two issues of current legislative interest are the extenders, and any potential legislation arising from the Treasury studies of donor advised funds and supporting organizations. In addition, there is interest, as indicated by hearings and by activities of the Senate Finance Committee in the tax-exempt status of non-profit hospitals and in university endowments. The Finance Committee has also in the past examined specific areas of the charitable giving and tax-exempt charitable world, including specific tax-exempt organizations. These examinations were spurred by studies and by media reports. Most recently, Senator Grassley has inquired of the finances of media related ministries. Finally, there remains a possibility that a floor could be imposed on charitable giving as part of a broad tax reform, given the recommendations of the President's Advisory Panel and the inclusion of that provision in the Congressional Budget Office options paper.

The Extenders

Table 1 reports the expected revenue cost of extending each of the six provisions that expired at the end of 2007 for one year. There are two issues associated with these charitable benefits "extenders:" whether they are effective or appropriate provisions, and, if so, whether they should be temporary when most of the provisions of the tax code are permanent. The specific issues associated with each of these provisions was discussed earlier.

Table 1: Charitable Provisions Among the Extenders

Provision	Revenue Cost (Millions of Dollars)
Individual Retirement Account Rollover	$465
Extending Food Inventory Provision	$71
Contributions of Scientific and Technological Property	$260
Contribution of Books	$32
Modifying the Basis of S Corporation Stock	$62
Unrelated Business Income of Related Parties	$35

Source: Joint Committee on Taxation, JCX26-08 [http://www.jct.gov/x-46-08.pdf].

The contributions of conservation property, which has already been extended two years, was estimated to cost $54 billion for a one year extension in an earlier estimate, JCX 107-07 [http://www.jct.gov/x-105-07.pdf].

One criticism that could be made of using temporary provisions for charitable purposes is that although the budgetary cost is smaller for a provision extended only a year at a time, the intention is to continue the provision. This practice causes the official projected budget deficits to be smaller than they will likely be, takes up the time of the Congress with considering the extenders, and creates some uncertainty for taxpayers.

On the other hand, an argument that could be made in favor of temporary provisions is that a temporary provision makes reconsideration of the merits and design of the provisions more likely. Evidence suggests, however, that relatively few temporary provisions have been revised. Only one extender of dozens allowed since the first extender was enacted in 1981 has been allowed to lapse. Most provisions are not revised either, although the R&D tax credit has been the subject of some major revisions. Nevertheless, it could be argued that the temporary nature of these provisions is conducive to better tax policy because provisions are reconsidered even though they are rarely revised.

The issues surrounding the specific charitable extenders are discussed above. History suggests they are likely to be enacted, however, and several bills have been introduced to extend all provisions that expired in 2007.[30]

Donor Advised Funds and Supporting Organizations

The two basic issues associated with donor-advised funds and supporting organizations were possibilities of receiving private benefit by donors and pay-out rates. As noted above, while some changes were enacted, others remain possible. Although payout requirements are planned (administratively) for Type III supporting organizations, there are no payout requirements for donor-advised funds and for other supporting organizations. These issues might be revisited when Treasury completes its studies.[31]

The Treasury was directed to study specific issues: whether deductions for contributions to donor-advised funds and supporting organizations are appropriate given the use of the assets or benefits to the donor, whether donor-advised funds should have a distribution requirement, whether the retention of rights by donors means that the gift is not completed, and whether these issues apply to other charities or charitable donors. Thus, it is possible that results of the studies could also have implications for charities in general.

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[30] See CRS Report RL32367, *Certain Temporary Tax Provisions ("Extenders") Expired in 2007*, by Pamela Jackson and Jennifer Teefy.

[31] See Nick Tarlson, "Donor Advised Funds: Prepare for Closer Scrutiny," *Journal of Accountancy*, 2008: [http://www.aicpa.org/pubs/jofa/jan2008/donor_advised_funds.htm].

Non-Profit Hospitals

The tax writing committees, and especially Senator Grassley, have also been interested in non-profit hospitals. A major concern is the degree of charity care and whether non-profit hospitals are providing benefits that justify their charitable and tax-exempt status. The Congressional Budget Office released a study in 2006 that found that non-profit hospitals overall provided only slightly more charity care than for profit hospitals.[32] The Senate Finance Committee held hearings on the topic "Taking the Pulse of Charitable Care and Community Benefits at Non-Profit Hospitals," on September 13, 2006 and the House Ways and Means Committee held hearings on "The Tax Exempt Hospital Sector," on May 26, 2005.

In a staff discussion draft released July 18, 2007 by Senator Grassley, the following concerns were raised about non-profit hospitals: establishing and publicizing charity care, the amount of charity care and community benefits provided, conversion of nonprofit assets for use by for-profits, ensuring an exempt purpose for joint ventures with for-profits, governance, and billing and collection practices.[33] Subsequently, on October 24, 2007, Senator Grassley authorized a round-table to discuss the draft. Also in July 2007, the IRS released an interim report on non-profit hospitals, where they found that the median share of revenues spent on charity care was 3.9% and almost half of hospitals spent 3% or less. The average was 7.4%.[34]

One of the concerns expressed in the staff discussion draft was that, since 1969, with a revenue ruling issued by the Internal Revenue Service, non-profit hospitals were not required to demonstrate specific standards for charity to qualify for exempt status (and in some cases to be eligible to receive tax deductible charitable contributions); rather they must meet a community benefit standard that is not quantitatively defined.[35]

University and College Endowments

Universities and colleges are classified as charitable organizations eligible to receive deductible contributions, and, also, as tax-exempt entities, do not pay tax on their investments. As indicated above, the benefit of exempting endowment income of colleges and universities from taxes is estimated at around $25 billion, more than three times the benefit of charitable deductions to all educational institutions. IN the past few years, endowments have been growing rapidly because of very high yields, coupled with relatively low payout rates. For the fiscal year that ended June 2007,

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[32] Congressional Budget Office, *Nonprofit Hospitals and the Provision of Community Benefits*, December 2006.

[33] *Tax Exempt Hospitals: Discussion Draft*, at: [http://finance.senate.gov/press/Gpress/2007/prg071907a.pdf]

[34] Internal Revenue Service, *Hospital Compliance Program Interim Report*, at: [http://www.irs.gov/pub/irs-tege/eo_interim_hospital_report_072007.pdf].

[35] See CRS Report RL34605, Tax-Exempt Section 501(c)(3) Hospitals: Community Benefit Standard and Schedule H, by Erika Lunder and Edward C. Liu for further discussion of the legal issues involved in defining community benefit.

endowments were $411 billion and the average rate of return was 21.5%. The payout rate was 4.6%. As a result of those relationships along with contributions, endowments grew 18.4% between FY2006 and FY2007 (about thee and a half times the growth rate of the economy), continuing an on-going trend from recent years. This growth may slow or reverse in FY2008, given the performance of the economy, but the trend in high earnings has persisted for longer periods of time inclusive of business cycles.[36]

The Senate Finance Committee received testimony on college endowments in connection with hearings held on offshore funds in 2007. Marge university endowments are invested in, among other assets, offshore hedge funds, and one issue discussed during the hearing was whether these investments were being used to avoid the unrelated business income tax. The witnesses discussed the growth of endowments and also addressed the relationship between endowments and affordability, showing that a very small increase in payout of universities and colleges with the largest endowments could obviate the need for tuition increases and could fund significant increases in student aid.[37] The Senate Finance Committee also sent a survey to colleges with endowments of more than $500 million to obtain more details about their endowments and pay-outs.[38] Senator Grassley, ranking member of the Finance Committee, recently discussed his concern that, in exchange for tax exemption, colleges were expected to provide affordable education, and why colleges were not spending more of their endowment funds for this purpose.[39]

Specific Sectors Including Media-Based Ministries

Over a period of time the Senate Finance Committee has examined specific charitable organizations or groups as well as specific charitable donation practices. Some of these investigations were spurred by media reports and some by IRS studies;

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[36] See "Special Report: Jitters Amid Strong Returns," *Chronicle of Philanthropy*, July 24, 2008, pp. 6-11. There was a similar period of slow growth during the 2001 recession, but funds still averaged high returns over the five year period that included the recession. See memorandum by Jane G. Gravelle. Congressional Research Service, analyzing endowment earnings, payouts, and uses that formed the basis for testimony, at: [http://finance.senate.gov/press/Gpress/2008/prg011408b.pdf].

[37] See testimony of Jane G. Gravelle, Congressional Research Service and testimony of Lynn Munson, Center for College Affordibility and Productivity, before the Senate Finance Committee, September 26, 2007:
[http://finance.senate.gov/hearings/testimony/2007test/092607testjg.pdf]
[http://finance.senate.gov/hearings/testimony/2007test/092607testlm.pdf].
Also see the memorandum by Jane G. Gravelle. Congressional Research Service, analyzing endowment earnings, payouts, and uses that formed the basis for testimony, at: [http://finance.senate.gov/press/Gpress/2008/prg011408b.pdf].

[38] Senate Finance Committee Press Release, "Baucus, Grassley Write to 136 Colleges, Seek Details of Endowment Pay-Outs, Student Aid.":
[http://finance.senate.gov/press/Gpress/2008/prg012408f.pdf].

[39] Charles E. Grassley, "Wealthy Colleges Must Make Themselves More Affordable," Chronicle of Higher Education, May 29, 2008:
[http://finance.senate.gov/press/Gpress/2008/prg052908d.pdf].

they have led to both legislation and self correction by entities involved. Some of these examples are mentioned in a summary of Senator Grassley's oversight available on the Senate Finance Committee's web page; they include in addition to issues associated with some of the provisions enacted in the Pension Protection Act and other bills, the Red Cross, the Nature Conservancy, and the Smithsonian.[40]

Recently, Senator Grassley has sent inquiries to several media based ministries for information on their finances. Religious organizations do not have to file the information (990) forms that other tax-exempt organizations have to file, so that it is difficult to obtain information. The issues of concern and status of this investigation, which relate to issues such as governance and compliance with tax withholding laws, are contained in a recent press release.[41]

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[40] Summary of Senator Chuck Grassley's Non-Profit Oversight, November 20, 2007: [http://www.senate.gov/%7Efinance/press/Gpress/2007/prg112007a.pdf].

[41] [http://finance.senate.gov/press/Gpress/2008/prg070708.pdf].