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Honorable Barber Conable

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TAX IMPACT ON CHARITABLE ORGANIZATIONS

HONORABLE BARBER CONABLE

I am very proud to be here, and I must say we have started out bright and early. Congress is going to do more work on tuition tax credit today. I do not know what is going to happen on that. There is, of course, fairly close division on the Committee. It is my expectation that we will wind up with a tuition tax credit on the college level. I suspect that a motion I made to limit it to 25% of tuition paid up to a certain amount will stick, in which case there will be a modest differential still between the benefits for the high private colleges and the lower state-supported universities. As to the elementary and secondary levels, I think we are going to get something, but I think it is going to be comparatively modest. I say that because we are engaged immediately following this exercise in an effort to shoehorn about \$200 billion of tax cuts into a \$25 billion shoe. That is a difficult exercise. The result, I think, is that we will accept the principle of tuition credit at the elementary and secondary levels, but probably not at the college level. That is my guess. I think once that is established and we have some experience with it there will be some basis for trying to give relief that will be more significant.

We all speculate: Nobody can commit the entire group of four hundred thirty-five views in the House and the one hundred views in the Senate as to what the appropriate measure should be. Yesterday morning there was an onslaught of public school people, particularly NEA people, attempting to turn around a decision which I think has been made on the elementary and secondary levels. There continues to be controversy, and there will be a minority on the Committee who will oppose any kind of tuition credit, feeling they would prefer to give relief to the middle class in a way that would be more broadly spread. Quite frankly, I have not always supported a tuition credit, but my feeling is that almost any kind of relief at this time to the middle class is appropriate. And I am very much concerned about the pluralism of our system. I find the concentration of so much decision-making power not only a creeping, but a galloping process. It is not in the interests of this country, and I try to do what I can to preserve pluralism.

In that connection, I have had an interesting time over the last five years working with the Charitable Lobbying Bill with which many of you are familiar, although it excludes church lobbying, for obvious reasons, and the church movement has been very much concerned about the *Christian Echoes* case and the right of the Supreme Court to define just what is a

church. We tried to arrive at a formula for determining substantiality, the level of permitted charitable lobbying. The churches, I think without exception, asked to be excluded from the substantiality issue, feeling that they would rather rely on the separation of church and state and continue to fight the trend represented by the *Christian Echoes* case. It took us a long time to get through the substantiality bill, generally called the Charitable Lobbying Bill. The reason, of course, was that many Congressmen were quite reluctant to take steps which they thought would release on them a torrent of cause-related lobbying.

The charities are generally staffed with volunteers and enthusiasts. The business lobbying that we get here in Washington is usually done by professionals who are interested in goodwill and want to come back another time, while the cause-related lobbyists are likely to arrive at the point of shaking their fists under the Congressman's nose and assuring him that they will get him if he does not go along with their particular cause. The result was that there was considerable reluctance on this score on the part of Congressmen, a feeling that there was going to be a quantum jump in the amount of importunate lobbying that would be addressed to areas of public interest if we succeeded in defining substantiality and thus removed from the charitable area the great concern about any lobbying and its impact on tax exemption. The bill has been in effect, now, for a year. We have seen some evidence that the charities are using it with some effect, but I must say that there has not been a torrent, because to assume that you could use up to 20% of your budget for lobbying as a charity was apparently a mistake. Twenty percent of the Boy Scouts' budget is not being used to lobby Congress about legislation, nor do the other charities so use their funds.

We have had, of course, some problems arising out of the Charitable Lobbying Bill, including definitional problems about what affiliated groups are, and that is a problem that carries over into the religious areas as well. That problem also has affected the area of ERISA, where I have recently sponsored a bill, at the request of a number of church groups, to try to define the relationship of affiliated groups in order to simplify the regulations that will apply for pensions. Pensions are a sore point in the area of charities, be they religious or 501(c)(3) nonreligious. Quite frankly, there has been some difficulty with ERISA as a result of the definitional problems, particularly in determining what is an associated group and what is not. I do not know if we will have any success. This is largely a technical bill. We will push it and try to get it included in tax legislation. It will be something that you should watch if you have problems of that sort in some of your associated church groups.

Another issue coming up, which may not have great acceptance this year, but which we felt was quite necessary to initiate, is the issue of charitable deductions in relation to the standard deduction. Jimmy Carter felt quite strongly that there was a big constituency for simplification of the tax law, and came to the Presidency with the assumption that sweeping changes would be possible. As you know, he pulled in his horns on that:

he has found that the realities facing the incumbent are quite different from what he assumed when he was a candidate. He has fallen back on the only easy thing to do in relation to simplification: namely, the expansion of the standard deduction. The Tax Reduction and Simplification Act of 1977 increased the standard deduction from 69% to 75%. Because Congress eliminated the deductions for state sales and gasoline taxes, and combined casualty and medical deductions and established a threshold, the President's proposals for tax reform in connection with the Act, which we will work on next week, would increase the number of people using the standard deduction to somewhere between 83% and 84%.

This has been going on for a long time. There has been a recent series of studies made at Harvard by a man named Feldstein indicating that it is taking its toll on charitable giving. Interestingly enough, it is doing this primarily in the religious charities. The mix of charitable giving is quite different at the different economic levels. The wealthiest people tend to give quite heavily to the universities and the educational charities, museums, art galleries, etc., where they can have their monuments in mortar and brick. But the poorer people concentrate their giving most heavily in the religious charities, e.g., United Funds, Catholic Charities, and the broadly based popular charities of that sort. Somewhere in the middle are all other 501(c)(3) organizations.

The result is, clearly, that if the growth of the standard deduction is reducing the incentives for charitable giving, it is afflicting primarily the churches. With that in mind, I sponsored, with Joe Fisher, a Democrat on the Ways and Means Committee, a bill which would permit the deduction of charitable contributions notwithstanding the use of the standard deduction. The cost of this would be about 3.4 billion dollars in lost revenue. It would generate about 3.6 billion dollars in additional charitable contributions, according to the studies that have been made. People do give slightly more if they are giving voluntarily than if they are giving involuntarily. The result is that there is a modest multiplier factor if you increase the tax incentive by permitting this kind of a deduction. Now, I do not expect this to get general acceptance. Quite frankly, there is a reluctance to make the short form longer. Anyone can understand that. If there is any constituency for simplification, we are working against simplification if we start giving deductions above the line or credits or whatever. The Filer Commission on Philanthropy made a recommendation of going to a credit, which would be pretty much the same thing, although they gave more than 100% at the lower level in order to broaden the base of philanthropy still further.

Regardless of whether or not this idea's time has come, it seems to me quite desirable to serve notice to the Administration that if it goes the route of constantly increasing the standard deduction, it must expect countering pressures from those who are directly and adversely affected by the loss of the charitable donation incentive. It is possible that we could pass something this year. However, given the comparatively limited tax cut coming after we have focused for a long time on all the wonderful ways to reduce taxes, I suspect that anything as large as 3.4 billion dollars in

lost revenue would be viewed with considerable skepticism. There would be a tendency on the part of most of the members to go the route of rate reduction given the further complication of extending the length of the short form. I think it is important, though, that we begin to talk about this. It is so easy to expand the standard deduction that frequently we forget that it does have some adverse effects and it does particularly affect charities. I am sure you believe, as I do, that we cannot afford to have the federal government as the sole problem solver. A plural society depends very strongly on the existence of a vast number of problem solvers in the non-profit area, as well as those in the deficit area, like government.

We will see what happens with it. It is going to be advanced, and my expectation would be that we are going to have to talk further about it. I do not expect the Committee or the Congress to accept most of the reforms that President Carter offered, the structural changes that would involve tax increases—including the ones I mentioned that would have the effect of increasing the standard deduction still further. It is possible we might eliminate the state tax on gasoline, but it is difficult to justify a deduction for discretionary driving. I doubt that we will eliminate the deduction for the sales tax, although that is a difficult one to administer, because there are some states that rely very heavily on the sales tax instead of on income tax. Thus, it has a very uneven impact across the tax landscape. I am certain that we are not going to permit a consolidation of casualty and medical losses which, in the view of many Congressmen on my Committee, has the tendency of hitting those people hardest who need the deductions the most.

I doubt that we are going to have a further step toward a larger standard deduction as a result of this year's deliberations. For that reason, I am somewhat skeptical about whether my measure to permit deductions in addition to a standard deduction will go anywhere. However, I do think it is important that people start thinking along these lines and begin to quantify the damage to American pluralism involved in the constant growth of the standard deduction.

There are very few people who will acknowledge they drink three martinis at lunch. I suspect that efforts to set down a list of proscribed activities which hereafter will not be deductible would probably create as many loopholes as they would close. We really do have a fairly tough tax; I would prefer to see the Committee give more money for revenue agents to press the issue of reasonable business purpose behind these various deductions, than get into a specific list of things, which would only test the ingenuity of salesmen, lawyers, and lobbyists to find additional ways in which they could confer benefits on their potential contacts. I cannot predict that we will not do something there because there is a certain populist ring to the phrase "the three martini lunch." However, I doubt that we are going to come up with anything that will be very satisfactory. We can deal with other issues in tax reform. I am happy to talk about the whole area. If you have special problems that you might like to exhort me about, I am happy to engage in dialogue with you.

QUESTIONS TO CONGRESSMAN CONABLE

Q. Mr. Conable, my name is Jules Kerner and I represent the National Catholic Education Association. I have two questions that I think might be of considerable interest to the group as a whole. They are unrelated. First, in reference to the Charitable Lobbying Act, which you first addressed yourself to this morning. The Code section refers to excluding churches from the provisions of the Charitable Lobbying Act. I believe it uses the words "churches or their integrated auxiliaries," and the question is of definition. Now, the Code section itself gives no definition of what that means. I believe that as yet there are no regulations on the subject, but as you may be aware, the term "integrated auxiliary" is defined elsewhere in the regulations under section 6033 with regard to filing returns. I am wondering whether it was the thought of Congress or of the Committee, at least in enacting this provision, that the same definition would apply in 501(h) and has now been promulgated in regulations in the return filing requirements of section 6033.

A. Well, I do not want to disillusion you, but I am afraid that Congress did not have any thoughts about it at all. It is rare that floor debate would deal with such an issue unless somebody had specifically raised it, and a question was asked in order to create legislative history on that particular issue. That particular question was worked out by Dr. Laurence Woodworth, who was then Executive Secretary of the Joint Committee on Internal Revenue Taxation. Toward the end of our deliberations there was considerable concern expressed by the church groups, and he volunteered to try to work out the difficulties with his staff. Your representatives were present, as were others, and Dr. Woodworth would normally have been in charge of the issuance of the regulations, since he went from that job to become the tax policy man at Treasury. Unfortunately, he had a stroke and died about four or five months ago. I am sure this has postponed the completion of the regulations. Don Lubick of Buffalo has succeeded him as acting policy man. He has to start from scratch on some of these issues, which may slow down the process.

Q. You can see that we do have a problem in trying to understand what this phrase means, and I suppose there would be a natural inclination for all of us, not finding a definition there, to seek a definition of the same words somewhere else and try to apply them.

A. And unless the regulations vary, that is probably the safest thing to do.

Q. My second question is as follows: You will recall that in the Tax Reform Act of 1976 a new section 513(d) was added regarding the exemption from the unrelated business income tax of income from trade shows and expositions. Section 513(d)(3) exempted from the unrelated business income tax income from trade shows and expositions carried on by section 501(c)(5) and (6) organizations, labor unions, and trade associations. There has been some suggestion that at one time, at least, section 501(c)(3) organizations were to be included in that exception. As the Act was passed,

501(c)(3)'s were dropped out. We presently have a very anomalous situation where a bona fide charity conducting the same kind of exposition, convention, or trade show within its field of interest as a trade association has to pay a tax on the same thing that a trade association does not have to.

A. Yes, I agree with you, it is anomalous. I can not recall what the problem was. It is something we could check.

Q. I wonder if there is anything going in the Committee at this time to correct that situation.

A. I am not aware of it, and I am not sure the Committee is aware that there has been a problem for 501(c)(3)'s. I am sure there are comparatively few meetings and conventions of that sort, at least in comparison to trade associations and labor unions. It may be something that should be called to the Committee's attention specifically.

Q. I am Nicholas Spinella from Richmond, Virginia, and am counsel for a fairly large Catholic hospital which does lobbying, primarily on the state level. Regarding the Charitable Lobbying Bill, was there any intent to change the criteria or rules concerning the lobbying efforts of a charitable organization that chooses to remain under the previous law and does not care to go in the new law?

A. That was not the intent. I know there was great concern, and I know there was some flopper. The religious charities were extremely nervous about my bill. But there was no intent, certainly, on the part of the author nor on the part of the Committee, to change any pattern in the religious area.

Q. George Reed: In January of this year, the Commissioner of Internal Revenue, in an address to the Practising Law Institute, stated there were two major problems confronting the Service. One, the problem of churches, was the definition of the term "church," and the other, discrimination in nonpublic schools. Yesterday, we had a speaker who had been in the Exempt Organizations Branch seven years, from 1970 to 1977. He confirmed that same attitude. Is there any comparable attitude in the Ways and Means Committee?

A. Well, I do not find that. I was personally very much interested in the number of black families that came before us in the course of the hearings to say, "We want the private school option, too. Our central city schools have failed us. And it is important that we be able to get some help in the areas of educational excellence and freedom of choice that used to be reserved only for those white middle class people who could afford it." It was quite impressive to me, because ten years ago if you supported the private school movement, you were assumed to be taking an elitist and racist attitude, regardless of the facts. That was the civil rights environment at that time. We had not had those maturing influences that have been changing the nature of our public school system. I believe there is a general feeling in Congress that, at least outside of the deep South, private schools are better integrated than public schools. That is not so in all cases, of course, but the serious examples of imbalance in integration are in

central city schools and suburban schools, each of which has become the province of much more racial exclusivity than private school systems, which have adapted, over the years, very considerably to the realities of our society. There were some amendments offered yesterday that raised the old racial spectre once again. I must say that some of our blacks still feel that the possibility for abuse in the private school system requires the aforementioned eternal vigilance and constant suspicion. However, as a general matter in Congress, I believe that there has been a considerable change in attitude toward the private school system in relation to the racial problem.

Q. Mr. Reed: One more short question: Would this charitable deduction above the line normally be associated, in the eyes of Treasury, at least, with a floor threshold?

A. Treasury would do that if they wanted a floor. They have suggested floors before for charitable giving, and, once again, that has the tendency to narrow the base of philanthropic support. In my personal view, that is becoming a serious problem. There are a lot of reasons why this is bad tax policy and also bad social policy. It is bad tax policy because as you cut down the number of people who are able to claim tax incentives those tax incentives look more and more like loopholes. In other words, if we were to go to 84% on the standard deduction, 16% could claim that particular type of tax incentive. I find it difficult to believe that ordinary charitable giving could be associated with loopholes. Yet, that is going to be the effect as you narrow the base. I think it is bad social policy because I do not think our charitable policy in this country should be dominated only by the very wealthy. Quite frankly, it is a problem in our universities, where we find that the people on the boards of trustees are those who might be expected to give very substantial testamentary bequests to their alma maters, and I do not think it is good for a university to have one type of person dominating the philanthropic policy of that particular eleemosynary institution. So I agree with the thrust of your remark, sir.