

To: Tax and Finance Practice Group Members

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The U.S. House of Representatives passed a new pension bill (H.R. 4) late Friday, July 28th, which includes various provisions applicable to tax-exempt organizations. Many of these provisions have origins in the Senate budget reconciliation bill (S. 2020) from last fall. As of Tuesday, Senate Majority Leader Bill Frist indicated his intent for the Senate to vote on the bill this Friday, August 4th, before it departs for its August recess. We have set forth below a general summary of the provisions that may be of particular interest to tax-exempt healthcare providers.

1. Section 1212: Increase in Penalty Excise Taxes Related to Public Charities, Social Welfare Organizations, and Private Foundations

The maximum potential penalty for "organization managers" under the intermediate sanctions, Internal Revenue Code Section 4958, which apply to excess benefit transactions, would be increased to \$20,000. An organization manager is defined as any officer, director, or trustee of the organization, or any individual having similar powers or responsibilities, regardless of title. Currently, organization managers are subject to an excise tax equal to five percent (5%) of the excess benefit, up to a maximum of \$10,000.

2. Section 1224: Disclosures to State Officials Relating to Exempt Organizations

Additional disclosures would be permitted by the Secretary of the Treasury to State officers under Internal Revenue Code Section 6104. The Secretary may notify the appropriate State officer in the case of a proposed refusal to grant Section 501(c)(3) status to an organization, or a proposed revocation of tax-exempt status of an organization. This would be an expansion of the current permitted disclosures of actual refusals and revocations.

Additionally, the Secretary would be able to notify the appropriate State officer in the case of a proposed deficiency of tax imposed upon a termination of private foundation status, and to disclose the names, addresses, and taxpayer identification numbers of organizations that have

applied for Section 501(c)(3) status.

The returns and return information subject to disclosure also would be made available for inspection to the appropriate State officer.

The bill provides that disclosures could be made only (1) upon written request by an appropriate State officer and only for the purpose of, and to the extent necessary in, the administration of State laws applicable to the organization, or (2) if the Secretary determines that disclosure of the returns or return information may provide evidence of the organization's noncompliance with State laws.

The disclosed returns and return information could be used in civil judicial or administrative proceedings related to the enforcement of State laws regulating the organization.

For purposes of these provisions, the term "appropriate State officer" would mean the State attorney general, the State tax officer, or any other State official charged with overseeing charitable organizations.

3. Section 1225: Public Disclosure of Information Relating to Unrelated Business Income Tax Returns

Forms 990-T filed by exempt organizations would be made subject to the public disclosure requirements under Internal Revenue Code Section 6104. Currently, the Form 990-T is not subject to public inspection.

4. Sections 1241 - 1245: Improved Accountability of Supporting Organizations

Internal Revenue Code Section 509(a)(3) would be amended to break out the three types of supporting organizations: "operated, supervised, or controlled" by one or more supported organizations (Type I); "supervised or controlled in connection with" one or more such organizations (Type II); or "operated in connection" with one or more such organizations (Type III). The term "supported organization" would be defined as the organization for whose benefit the supporting organization is organized or operated, or with respect to which the supporting organization performs the functions of, or carries out the purposes of.

A new Section 509(f) would state that the responsiveness test for Type III supporting organizations is met only if the supporting organization provides to the supported organization information required by the Secretary to ensure that the needs or demands of the supported organization are met.

Section 509 also would be amended to exclude from the definition of supporting organizations such organizations that have foreign supported organizations, and to give these organizations a three-year transition period before the prohibition would become effective.

Also excluded from the definition of Type I and Type III supporting

organizations would be those organizations that accept gifts or contributions from a person who directly or indirectly controls the governing body of the supported organization, a family member of such person, or an entity controlled 35% or more by such person.

The bill provides that a charitable trust would not be considered to be a Type III supporting organization solely because it is a charitable trust under State law, the supported organization is a beneficiary of the trust, and the supported organization has the power to enforce the trust and compel an accounting.

The Secretary would be charged with promulgating new regulations on payments required by Type III supporting organizations that are not "functionally integrated Type III supporting organizations." (Under proposed amendments to Section 4943, the term "functionally integrated Type III supporting organization" would be defined as a Type III organization that is not required, under regulations to be established by the Secretary, to make payments to supported organizations.) The regulations are to require such organizations to make distributions of a percentage of either income or assets to supported organizations in order to ensure that a significant amount is paid to the supported organizations.

Section 4958 also would be amended to expand the definition of disqualified persons to include persons in a position to exercise substantial influence over the affairs of a supporting organization within the five-year lookback period, a family member of such person or a 35% controlled entity. These amendments are to be effective for transactions occurring after July 25, 2006.

Section 4958 would be further amended to include in the definition of excess benefit transaction any grant, loan, compensation, or other similar payment provided by a supporting organization to a substantial contributor, a family member of such substantial contributor (if an individual), or a 35% controlled entity. The definition also would include any loan provided by the supporting organization to a disqualified person. For these purposes, "substantial contributor" would mean any person who contributed or bequeathed an aggregate amount of more than \$5,000 to the organization, if such amount is more than 2% of the total contributions and bequests received by the organization in the taxable year, and in the case of a trust, the creator of the trust.

Section 4943, which imposes taxes on excess business holdings of private foundations engaged in business enterprises, would be amended to treat Type III supporting organizations, other than a functionally integrated Type III supporting organization, as private foundations. Additionally, Type II supporting organizations that accept any gift or contribution from a substantial contributor, a family member of such individual, or a 35% controlled entity would be treated as private foundations for purposes of the excess business holdings tax.

The definition of excess business holdings would specifically exclude any holdings of Type III supporting organizations in any business enterprise if,

as of November 18, 2005, the holdings were held, and continue to be held, for the benefit of the community pursuant to the direction of a State attorney general or other State official with jurisdiction over the organization.

Section 4942 would be amended to limit distributions by non-operating private foundations to supporting organizations. Amounts paid by a non-operating private foundation to a Type III supporting organization that is not a functionally integrated Type III supporting organization would be excepted from the definition of qualifying distribution. Also excluded from this definition would be amounts paid to Type I, Type II, and functionally integrated Type III supporting organizations if a disqualified person of the private foundation directly or indirectly controls the supporting or supported organization, or the Secretary otherwise determines by regulations that the distribution is inappropriate.

Section 6033 would be amended to take out of the Secretary's discretion relieving supporting organizations from filing an information return. Additionally, Section 6033 would be amended to require supporting organizations to include on their information returns a list of supported organizations to which they provide support, an indication of whether the organization meets one of the three tests for supporting organization status, and a certification that the organization is not controlled directly or indirectly by one or more disqualified persons.

The Tax and Finance Practice Group would like to thank Mindy Fox Staley, Esq. of Nexsen Pruet Adams Kleemeier PLLC, Charlotte, NC, for preparing this email alert.

Member benefit educational opportunity:
Caracci impact on tax-exempt healthcare providers [teleconference](#) (August 9, 2006).

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