[JOINT COMMITTEE PRINT]

DESCRIPTION OF TAX BILLS

(S. 696, S. 1757, and S. 1883)

SCHEDULED FOR A HEARING

BEFORE THE

SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT

OF THE

COMMITTEE ON FINANCE

ON DECEMBER 11, 1981

PREPARED FOR THE USE OF THE

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BY THE STAFF OF THE

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INTRODUCTION

The bills described in this pamphlet have been scheduled for a public hearing on December 11, 1981, by the Senate Finance Subcommittee on Taxation and Debt Management.

There are three bills scheduled for the hearing: (1) S. 696 (relating to private foundations status of certain library organizations); (2) S. 1757 (relating to tax-exempt status of certain amateur athletic organizations); and (3) S. 1883 (relating to net operating loss treatment of the Federal National Mortgage Association).

The first part of the pamphlet is a summary of the bills. This is followed by a more detailed description of the bills, including present law, issues, explanation of provisions, effective dates, and estimated revenue effects.

I. SUMMARY

1. S. 696—Senator Danforth

Exclusion from Private Foundation Status of Certain Library Organizations

Under present law, the term "private foundation" means any tax-exempt charitable, religious, scientific, public safety, literary or educational organizations, other than certain specified types of organizations that could be described as "public charities." "Public charities" include (1) certain organizations defined principally in terms of their function (churches, schools, hospitals, certain medical research organizations, and governmental units), (2) certain organizations that receive specified amounts of "public" support, and (3) organizations that are "supporting" organizations to other public charities.

Under the bill, an organization that operates a qualified library would be excluded from private foundation status. A qualified library would be one that was established as a library by a law of a State, of the United States, of a possession of the United States, of the District of Columbia, or, before 1789, in the geographic area now comprising the United States, and that is operated by the organization as a permanent and principal part of its public services. Alternatively, a qualified library would be any library that is open and available to the general public, does not charge a fee for admission or for use of the library collection on its premises, and is operated by an organization, none of whose income is expended for purposes other than the construction, maintenance, expansion, operation, or management of such library and its premises.

The bill is intended to benefit principally two libraries, the St. Louis Mercantile Library, located in St. Louis, Missouri, and the Linda Hall Library, located in Kansas City, Missouri.

The provisions of the bill would be effective on the date of enactment.

2. S. 1757—Senator Stevens

Tax-Exempt Status of Certain Amateur Athletic Organizations

Under present law, athletic organizations which teach youth or which are affiliated with charitable organizations have been able to qualify for exemption under section 501(c)(3) of the Code and have been eligible to receive tax-deductible contributions. In addition, the Tax Reform Act of 1976 provided that certain athletic organizations also could be eligible for exemption and could receive tax-deductible contributions. In order for this group of athletic organizations to qualify, the organization must be organized and operated for the primary purpose of fostering national or international amateur sports competition, but only if no part of the organization's activities involves the provision of athletic facilities or equipment.

The bill would provide that certain athletic organizations would be exempt under section 501(c)(3) and could receive tax-deductible contributions despite the fact that the organization provides athletic facilities or equipment or that its membership is local or regional in nature where the organization was organized and operated to conduct national or international competition in certain sports or to support and develop amateur athletes for national or international competition in those sports. The bill would be effective as of October 5, 1976.

3. S. 1883—Senator Packwood, et al.

Net Operating Loss Treatment of the Federal National Mortgage Association

Under present law, taxpayers generally may carry back a net operating loss (NOL) for 3 years and carry forward an NOL for 15 years. Banks and certain other financial institutions are permitted a special 10-year carryback and a 5-year carryover. The Federal National Mortgage Association (FNMA) is not eligible for the special 10-year NOL carryback, and thus must use the 3-year carryback and 15-year carryover rule.

The bill would provide a 10-year carryback and a 5-year carryover for NOL's of the FNMA. Thus, the carryback period would be lengthened by 7 years and the carryover period would be shortened by 10 years. The bill would be effective for NOL's incurred in taxable years beginning after December 31, 1981.

II. DESCRIPTION OF THE BILLS

1. S. 696—Senator Danforth

Exclusion from Private Foundation Status of Certain Library Organizations

Present Law

Under section 509(a) of the Code, the term "private foundation" means any tax-exempt charitable, religious, educational, or other organization described in section 501(c)(3), *other than* certain specified types of organizations. These excluded organizations, which could be called "public charities," include (1) certain organizations defined principally in terms of their function, such as churches, schools, hospitals, certain medical and research organizations, and governmental units; (2) certain organizations that receive specified amounts of "public" support, such as grants, contributions, membership fees, admission fees and fees for performance of services not unrelated to their tax-exempt purpose; (3) organizations that are "supporting" organizations to other public charities; and (4) organizations operated exclusively for the testing for public safety.

A private foundation is subject to an annual two-percent excise tax on its net investment income (sec. 4940). Generally, a private foundation also is subject to excise taxes if it fails to make specified annual distributions for exempt purposes, violates prohibitions against acquiring or holding "excess" business interests, makes investments deemed to jeopardize its exempt purposes, or makes certain "taxable expenditures" (secs. 4942–4945). In addition, excise taxes are imposed on any act of self-dealing between a disqualified person and a private foundation; such taxes are to be paid by the disqualified person and any foundation manager participating in the act of self-dealing (sec. 4941).

Under section 170 of the Code individuals generally may deduct gifts of cash to public charities or to private operating foundations [1] to the extent of 50 percent of their adjusted gross income in the year of contribution with a five-year carryforward of any excess. In contrast, gifts of cash to nonoperating private foundations generally are deductible to the extent of 20 percent of adjusted gross income, with no carryforward. Also, a donor of long-term capital gain property to a public charity or private operating foundation generally can deduct

[1] In general, a private foundation is an "operating foundation" if it spends substantially all of its adjusted net income or its minimum investment return, whichever is less, directly for the conduct of its exempt purpose, and if it meets one of three other tests (sec. 4942(j)(3)).

the property's fair market value up to 30 percent of the individual's adjusted gross income (with a 5-year carryforward), whereas with contributions of such property to nonoperating private foundations, the deductible amount generally equals fair market value less 40 percent of the gain that would have been recognized if the property had been sold, is limited to 20 percent of the individual's adjusted gross income, and has no available carryforward.

Issue

The issue is whether the categories of charitable organizations excluded from private foundation status should be expanded to include certain organizations that operate either (1) libraries that were established by State or Federal statute, or (2) libraries that are open to the public free of charge.

Explanation of the Bill

The bill would exclude from private foundation status an organization that operates a qualified library by amending section 170(b)(1)(A)(ii) of the Code (relating to percentage of income limitations on deductions to charitable organizations), which describes educational organizations, to include any organization that operates a qualified library. Organizations described in that section are already excluded, by cross reference, from private foundation status.

To be treated as a qualified library under the bill, such library (a) must have been established as a library by a law of a State, a law of the United States, a law of a possession of the United States, a law of the District of Columbia, or, before 1789, in the geographic area now comprising the United States, and (b) must be operated by an organization as a permanent and principal part of its public services.

Alternatively, a library will be treated as a qualified library if it (a) is open and available to the general public, (b) does not charge a fee for admission or use of its collection on the premises, and (c) is operated by an organization, none of whose income is expended for purposes other than the construction, maintenance, expansion, operation, or management of the library, its collection, and the premises on which it is located.

An organization that, for its first taxable year beginning after the date of enactment, is an "organization which operates a qualified library" under the bill would be treated as not having been a private foundation at any time before the first day of such first taxable year.

The bill is intended to benefit principally two libraries, the St. Louis Mercantile Library, located in St. Louis, Missouri, and the Linda Hall Library, located in Kansas City, Missouri.

Effective Date

The provisions of the bill would be effective on enactment.

Revenue Effect

It is estimated that this bill would reduce fiscal year budget receipts by less than $1 million annually.

2. S. 1757—Senator Stevens

Tax-Exempt Status of Certain Amateur Athletic Organizations

Present Law

Under present law, athletic organizations which teach youth or which are affiliated with charitable organizations have been able to qualify for exemption under section 501(c)(3) of the Code and have been eligible to receive tax-deductible contributions. In addition, the Tax Reform Act of 1976 provided that certain athletic organizations also could be eligible for exemption under section 501(c)(3) and could receive tax-deductible contributions. In order for this latter group of athletic organizations to qualify for exemption under section 501 (c)(3), the organization must be organized and operated for the primary purpose of fostering national or international amateur sports competition, but only if no part of the organization's activities involves the provision of athletic facilities or equipment. The purpose of the restriction of athletic facilities and equipment was to prevent the allowance of tax benefits, including deductible contributions, for organizations which, like social clubs, provide facilities and equipment for their members.

Because of these restrictions, the Internal Revenue Service has not granted favorable rulings to a number of athletic organizations, including the national governing boards of several sports, because those organizations provided athletic facilities or equipment or because the membership of those organizations is local or regional in nature.

Issues

The issues are whether tax exemption under section 501(c)(3) and tax-deductible contributions should be allowed to an athletic organization which provides athletic facilities and equipment or which has a membership which is local or regional in nature so long as the organization is organized and operated primarily (1) to conduct national or international competition in sports played in the Olympic or Pan-American games or (2) to support and develop amateur athletes for national or international competition in such sports.

Explanation of the Bill

The bill would provide that certain athletic organizations organized and operated exclusively to foster national or international sports competition would be exempt under section 501(c)(3) and could receive tax-deductible contributions despite the fact that the organization provides athletic facilities or equipment or that its membership is local or regional in nature. Organizations qualifying for this treat-

ment under the bill would be those organizations which are organized and operated primarily (1) to conduct national or international competition in sports included on the program of the Olympic games or the Pan-American games or (2) to support and develop amateur athletes for national or international competition in such sports.

Effective Date

The provisions of the bill would be effective on October 5, 1976.

Revenue Effect

It is estimated that this bill would reduce fiscal year budget receipts by less than $5 million per year.

3. S. 1883—Senator Packwood, et al.*

Net Operating Loss Treatment of the Federal National Mortgage Association

Present Law

Prior to enactment of the Economic Recovery Tax Act of 1981 (ERTA), taxpayers could carry back a business net operating loss (NOL) against income for the 3 taxable years preceding the loss year and carry forward any remaining unused losses to the 7 years following the loss year (sec. 172). ERTA generally increased the carryover period to 15 years and retained the 3-year carryback.

There are a number of exceptions to the general 3-year carryback and 15-year carryover rule for certain industries or categories of taxpayers. One exception allows a 10-year carryback and a 5-year carryover for NOLs of financial institutions to which section 585, 586, or 593 (relating to the bad debt treatment of commercial banks, small business investment corporations, and savings and loan associations, and certain other thrift institutions respectively) applies (sec. 172(b)(1)(F)). In the Tax Reform Act of 1969, which added the special NOL rule applicable to financial institutions, Congress generally reduced the allowable deductions for additions to bad debt reserves for those financial institutions. Section 172(b)(1)(F) was added to ensure that, after reduction of the bad debt deduction, there would be adequate protection against substantial losses due to any future downtrends in the economy.[1]

Since the Federal National Mortgage Association (FNMA) is not described in sections 585, 586, or 593, it is not eligible for the 10-year carryover treatment, and thus must use a 3-year carryback and a 15-year carryover. FNMA is a corporation chartered by Congress to provide assistance, liquidity, and stability to the home mortgage market.[2]

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*Cosponsors are Senators Moynihan, Roth, Danforth, Symms, Chafee, Durenberger, Long, Bentsen, Baucus, Matsunaga, Mitchell, Garn, and Lugar.

[1] The 10-year carryback provided by the Tax Reform Act of 1969 was effective for financial institutions other than cooperative banks for losses incurred in taxable years beginning after December 31, 1975, and for cooperative banks for losses incurred in taxable years beginning after December 31, 1969.

[2] FNMA serves two related functions. First, it helps housing by providing a secondary market for mortgages. Also, with respect to mortgage bankers. FNMA generally functions as a primary source of financing, since mortgage bankers are not depository institutions and generally make loans only if they have commitments from FNMA to buy them.

FNMA also offers mortgage lenders a way to hedge against changes in interest rates. It does this by making commitments to buy mortgages at a fixed price 4 months in the future.

Issue

The FNMA typically provides a secondary market for mortgages by borrowing on a short-term basis and investing in long-term mortgages. In this respect, the FNMA operates similarly to certain of the financial institutions which are eligible for the 10-year carryback of net operating losses.

The issue is whether the FNMA should have 10-year carryback and 5-year carryover periods similar to the rule applicable to certain other financial institutions.

Explanation of the Bill

The bill would amend section 172(b) to provide a 10-year carryback and a 5-year carryover of NOL's of the FNMA. Thus, the carryback period would be lengthened by 7 years, and the carryover period would be shortened by 10 years.

Effective Date

The bill would be effective for NOL's for taxable years of the FNMA beginning after December 31, 1981. Thus, for example, a net operating loss for calendar 1982 could be carried back as far as 1972.

Revenue Effect

It is estimated that this bill would reduce fiscal year receipts by $14 million in 1983 and increase fiscal year receipts by $14 million in 1984.