Legislative Alert
September 20, 2016

The following items were reported on by Jack Owen, Esquire at our last meeting on September 20, 2016:

The IRS has given new life to charitable remainder annuity trusts by changing the 5% Probability Test. Under the 5% Probability Test, if there is a 5% or greater probability using the selected applicable federal rate that the trust beneficiary will live long enough for the trust to be exhausted, then the trust will fail to qualify as a charitable remainder annuity trust (CRAT).

Over the last several years, it has been incredibly difficult for CRATs to pass the 5% Probability Test due to very low interest rates, as reflected in the AFR. This is because a CRAT paying out the minimum 5% annuity would still be paying out more than the assumed earnings rate reflected in the AFR. Consequently, a trust paying out more than it earns would eventually exhaust and fail the 5% Probability Test.

Fortunately, the IRS has come to the rescue in Revenue Procedure 2016-42. In this ruling, the IRS indicated that through the use of a qualified contingency, the 5% Probability Test is disregarded. The qualified contingency is a new provision which must be drafted by the creator of the trust, and it will effectively terminate the trust if, at some later date, the trust value is less than 10% following the next annuity payment. Some are referring to this provision as the 10% Termination Test.

CRATS are a complicated subject and such planning should only be done with experienced tax professionals. The effect of a CRAT termination is that the donor's annuity payments would stop, and any remaining trust balance would be paid to the charity. This type of transaction should only be done with full disclosure and with very careful planning.

A subcommittee of the House Ways and Means Committee held its first hearing to investigate higher education costs and the endowments of colleges and universities. The subcommittee expressed concern about rising tuition costs and stressed that colleges and universities should be doing more with their endowments to offset these rising costs. Some of the testimony called on colleges and universities to provide more data on their IRS Form 990 information returns regarding endowment returns and expenses, and the value of state real estate tax exemptions. Also, some recommended imposing a foundation-style excise tax on larger endowments and using the proceeds to subsidize community colleges. The hearing ended with promises of more hearings and potential draft legislation again pointing out that no one is safe when Congress is in session.

The Final Regulations for the U.S. Department of Labor's overtime rules are due to go into effect on December 1.Many groups have requested a postponement of the December 1 deadline for compliance, noting the onerous effects on nonprofits and small businesses. Most commentators agree that the overtime regulations will go into effect on December 1, 2016, as it is likely that President Obama would veto any legislative postponement, and it is unlikely that Congress has the votes to override a Presidential veto. Bottom line:Nonprofits need to plan for implementation of the new overtime rules effective December 1, 2016.

The Urban Institute and Columbia Law School released a report, “State Regulation and Enforcement in the Charitable Sector”, based on data collected in 2013 and 2014 from 47 of the 56 state and U.S. territorial jurisdictions with oversight over charitable organizations. According to this report, the three most common areas of state enforcement include fundraising, trust enforcement and governance. Oversight, however, includes a complex mix of other substantive areas, including charitable trust law, governance, criminal law, solicitation registration requirements, corporation transactions, and conservation easements. A frequent partner with whom regulators reported working with to promote education and outreach to charitable organizations includes state nonprofit associations such as the Pennsylvania Association of Nonprofit Organizations (PANO).

In First Baptist Church of St. Paul vs. City of St. Paul, it was determined that local governments in Minnesota could not circumvent the Minnesota state constitution’s prohibition against taxing the property of charitable nonprofits by disguising a “tax” and relabeling it as a “fee”, as the Minnesota Supreme Court ruled on August 24, 2016.In this case, Minnesota municipalities experiencing fiscal challenges sought to generate new revenues from charitable nonprofits through creative methods such as imposing street lighting “fees” and assessing street maintenance “fees”, instead of “taxes”. Two churches joined together to bring a lawsuit contending that the imposition of a right of way maintenance fee was not a special assessment benefitting a specific property but a general tax, and subject to constitutional limits. The Minnesota Supreme Court agreed with the churches and reversed a lower court ruling, finding that the privilege and entitlement of charitable tax exemption had been wrongfully and detrimentally eroded by recasting taxes as fees. This case could be valuable and prove persuasive in 17 other states that have a charitable property tax exemption in their state constitution, which would include Pennsylvania.