



american society of
association executives

PRESIDENT'S ADVISORY
PANEL
ON FEDERAL TAX REFORM

2005 MAR 28 P 5: 25

Advancing Your Success

March 9, 2005

Mr. Jeffrey F. Kupfer
Executive Director
The President's Advisory Panel on Federal Tax Reform
1440 New York Avenue NW, Suite 2100
Washington, DC 20220

Dear Mr. Kupfer:

On behalf of America's trade and professional associations, I express a healthy appreciation for the task that befalls the President's Advisory Panel on Federal Tax Reform. Ultimately, I know the panel will recommend options that make the tax code simpler, fairer and pro-growth for all Americans.

To assist in the panel's deliberations, the American Society of Association Executives (ASAE) submits the following report prepared by the accounting firm Tate & Tryon titled "Impact of Tax Restructuring Proposals on Associations."

According to the Internal Revenue Service (IRS), there are currently more than 71,000 501(c)(6) trade and professional associations operating in the U.S., and more than 230,000 501(c)(3) charities, foundations and other donor-based organizations that file Form 990 or Form 990-EZ returns with the IRS.

The following report examines the major provisions of the various legislative proposals and the potential impact on trade and professional associations, as well as touching on implications for the philanthropic community. Both sectors have a significant stake in tax restructuring. I hope the panel finds the report informative and useful in its deliberations.

Please contact ASAE's vice president of public policy, Jim Clarke, at 202-626-2703 if the panel has any questions relative to the report or would like to discuss any portion of the report further.

Sincerely,

John H. Graham IV, CAE
President and CEO

The ASAE Building
1575 I Street, NW
Washington, DC
20005-1103

Enclosure

202-626-ASAE (2723)
fax 202-371-8825
www.asaenet.org

IMPACT OF TAX RESTRUCTURING PROPOSALS ON ASSOCIATIONS

Prepared By:

Charles Tate, CPA

Edited By:

Adam Kemp, CPA

David Duren, CPA

TATE & TRYON

Washington, DC

February 23, 2005

For The:

AMERICAN SOCIETY OF ASSOCIATION EXECUTIVES

IMPACT OF TAX RESTRUCTURING PROPOSALS ON ASSOCIATIONS

CONTENTS

| | |
|---|-----------|
| OVERVIEW | 1 |
| CONSUMPTION TAXES | 3 |
| Flat Tax | 3 |
| National Retail Sales Tax..... | 3 |
| Value-Added Tax | 3 |
| ASSOCIATIONS AND THE FLAT TAX | 5 |
| Tax Exemption and Unrelated Business Income | 5 |
| Deductibility of Member Dues | 6 |
| Deductibility of Lobbying Expenditures | 6 |
| Noncash Compensation..... | 6 |
| Association Executives and Qualified Retirement Plans | 6 |
| Summary..... | 7 |
| ASSOCIATIONS AND THE SIMPLIFIED USA TAX | 8 |
| Tax Exemption | 8 |
| Taxable Receipts | 8 |
| Business Purchases | 9 |
| Payroll Tax Credit..... | 9 |
| Illustration – Association Formerly Exempt Under Section 501(c)(3) | 9 |
| Summary..... | 11 |
| ASSOCIATIONS AND THE NATIONAL RETAIL SALES TAX | 12 |
| Tax Exemption | 12 |
| Taxable Purchases | 13 |
| Exempt Purchases..... | 13 |
| Association Dues | 13 |
| Education and Research Activities..... | 14 |
| Purchases For Resale | 14 |
| Exports From the United States..... | 14 |
| Other Aspects of the NRST | 15 |
| Illustration..... | 15 |
| Summary..... | 17 |
| CONCLUSION | 18 |
| TABLE SUMMARY OF IMPACT OF TAX RESTRUCTURING PROPOSALS ON ASSOCIATIONS | 19 |

Overview

The past two decades have witnessed rapidly growing dissatisfaction, on the part of the American taxpayer and on the part of economists and tax policy experts as well, with the complexity and inefficiency of our present tax system. Americans, supported by influential members of Congress, have been engaged in an intense public debate about the need for structural tax reform that might go so far as to scrap the current tax system. During the past few years, a number of legislative proposals for reforming or overhauling the federal income tax system have been introduced in Congress. These proposals come in many shapes and sizes, with the idea of a consumption-based tax being the main feature.

The impact of tax restructuring on certain tax-exempt organizations, namely charitable organizations, has already been a topic of considerable discussion. Much of that discussion has focused on the elimination, or at least curtailing, of the deduction for charitable contributions contained in several of the proposals. For instance, one *Flat Tax* proposal discussed later in this paper would eliminate the deduction for charitable giving. The same proposal could also cause a 17% rise in the cost of providing employee benefits, other than retirement. The *USA Tax*, also discussed later, would actually increase the incentive for charitable giving by extending the deduction to nonitemizers. The *USA Tax* would remove the exempt status of certain categories of 501(c)(3)s, notably those that primarily conduct seminars, produce books and pamphlets, or conduct research on public policy issues. The *National Retail Sales Tax* would require charitable organizations to pay a tax on most items they purchase for their own use. It is also likely that the states that currently exempt 501(c)(3) organizations from paying sales tax would be forced to remove that exemption in order to conform to the national sales tax rules. Since it would also remove all taxes on investment income, the advantage of tax-exempt savings and investment that charities enjoy, in preference to for-profits, would be removed.

Much of this short review of the impact on charitable organizations does not apply at all, or applies in differing ways, to associations, which are the focus of this paper. Associations, however, represent a special category of tax-exempt organizations offering a unique array of products and services to their members, as well as to the public. Although some of the proposals sustain the tax exemption for associations, others leave associations open to taxation like any other business entity. In many respects, associations may have a bigger stake in tax restructuring than charitable

organizations. This report is intended to review the major provisions of the various legislative proposals, as they would affect associations, a unique category of tax-exempt organization.¹

¹ While most associations are exempt under Section 501(c)(6) of the Internal Revenue Code, many others are exempt under 501(c)(3) and 501(c)(4). This report focuses on the business tax features of the proposals that will likely have a major impact on associations. Although the individual tax features of the proposals will have considerable impact on the demand for associations' products and services, this report will concentrate on the changes in tax rules affecting associations internally, rather than attempting an economic analysis of the impact of external changes.

Consumption Taxes

The thrust of almost all recent tax overhaul proposals is to convert the U.S. from an income-based to a consumption-based tax system. The central argument is that our current system penalizes saving and investing, which has resulted in the U.S.'s current standing near the bottom of the list of industrialized nations in its rate of saving. Thus, the argument goes, the economic activity of producing and consuming goods and services should be taxed, but not the economic activity of saving and investing. Hence the term "consumption tax."

There are many types of consumption taxes, but three in particular have been backed by recently proposed legislation:

1. *Flat Tax*

- Tax Simplification Act of 2003: Proposed by Sen. Richard Shelby (R-AL) in the 108th Congress (S. 1040). Companion bill (H.R. 3060) introduced by Rep. Nick Smith (R-MI).
- Flat Tax Act of 2003: Proposed by Sen. Arlen Specter (R-PA) in the 108th Congress (S. 907).

2. *National Retail Sales Tax*

- Individual Tax Freedom Act of 2004: Proposed by Rep. W.J. (Billy) Tauzin (R-LA) in the 108th Congress (H.R. 4168).
- Fair Tax Act of 2003: Proposed by Rep. John Linder (R-GA) in the 108th Congress (H.R. 25). Companion bill (S. 1493) introduced by Sen. Saxby Chambliss (R-GA).

3. *Value-Added Tax (VAT)*

- Simplified Unlimited Savings Allowance (USA) Tax Act of 2003: Proposed by Rep. Phil English (R-PA) in the 108th Congress (H.R. 269).

The discussion of consumption taxes usually includes the reference to a Value-Added Tax or "VAT" that is levied by almost every major industrialized country, except the United States. There are two basic methods of imposing VAT – the credit invoice method and the subtraction method. The credit invoice method requires the collection and forwarding of a great deal of documentary support for VAT already paid at earlier stages in the production or distribution of the goods being taxed. There has been little consideration of the credit invoice method on Capitol Hill. The subtraction method simply involves computing the full VAT on all goods or services processed by

the business taxpayer, and subtracting all VAT paid to others during the same time period. Both the Simplified USA Business Tax and the Flat Business Tax are based on the subtraction method VAT. However, the Flat Business Tax works as a modified VAT, allowing for additional deductions for wages, salaries, and pensions. Thus, the remainder of this report will deal with VAT in the context of the Simplified USA and Flat Tax Proposals, rather than VAT as a separate category of consumption tax.

Associations and the Flat Tax

Several proposals introduced in the most recent session of Congress are based on the concept of a "Flat Tax." The Flat Tax in reality is simply one variation of a consumption tax, because it proposes to tax (at a much lower rate, and with far fewer offsetting deductions) the income earned from producing and consuming goods and services as opposed to income from investment.

The Shelby Flat Tax proposal would impose a 17 percent tax on individuals and businesses.² For businesses, the tax would be applied to the entity's "business taxable income." The Shelby proposal defines "business taxable income" to include sales in connection with a business activity. As a result, interest, dividends, and capital gains are exempt from taxation.

The Specter Flat Tax proposal would impose a slightly higher tax of 20 percent on individuals and businesses. As in the Shelby proposal, the tax would be applied to an entity's "business taxable income." The Specter proposal's definition of "business taxable income" specifically excludes investment income. As a result, interest dividends, and capital gains are exempt from taxation.

Tax Exemption and Unrelated Business Income

The Shelby proposal specifically provides that "business taxable income" excludes any activity of an organization that is currently exempt from tax under the Internal Revenue Code. However, the proposal amends only specific sections of Subchapter A and does not affect the unrelated business income tax provisions of Subchapter F. Therefore, it appears that, under the Shelby proposal, a tax-exempt organization would continue to receive exempt status for activities related to its exempt purpose, while its unrelated business income would be subject to the Flat Tax under Subchapter F.

In contrast to the Shelby proposal, the Specter proposal levies tax on "every person engaged in a business activity," but does not mention an exemption for tax-exempt organizations. While it would seem logical that a not-for-profit's exempt function income would be excluded from the tax, the specifics of the Specter Flat Tax are not clear from the few short pages of the bill.³ If the

² The rate would have been 19 percent through 2004.

³ Like the Shelby proposal, the Specter Flat Tax Proposal amends only certain sections of Subtitle A of the Internal Revenue Code dealing with income taxes. It contains no specific references to amending Subchapter F. Exempt Organizations. As a result, it would appear that the practice of taxing only unrelated business income under Subchapter F would continue to apply.

intent were to retain the current rules for taxation of unrelated business income, the Specter proposal would compute the tax on such income under the flat tax provisions.

Deductibility of Member Dues

Deductions from gross income generally include cash wages and retirement contributions currently allowed as a deduction, and the cost of business inputs.⁴ The cost of business inputs generally means property and services sold or used in a trade or business. It appears that dues paid by an association's business members would continue to be deductible as services paid in connection with their own business activity.

Deductibility of Lobbying Expenditures

As under current law, the Specter proposal would clearly disallow the deduction for most lobbying and political expenditures.⁵ Although the Shelby proposal contains no specific language, it appears as though the current limitations on lobbying and political activities by exempt organizations would be sustained.⁶

Noncash Compensation

A rather significant provision under the Shelby proposal would impose a special 17 percent tax on associations and other tax-exempt entities that provide noncash compensation to employees.⁷ Noncash compensation generally means any remuneration other than wages and retirement plan contributions.⁸ Examples of noncash compensation include employer provided health insurance, commuting and parking allowance, entertainment facilities, spouse travel allowances, and salary reductions under flexible benefit plans. The Specter proposal contains no such language.

Association Executives and Qualified Retirement Plans

An interesting provision of the Shelby proposal would make association executives and other highly compensated individuals eligible for higher contributions to qualified plans because of the

⁴ S. 1040, Section 102(a), and S. 907, Section 2(a), proposing new Code 11(d)(1).

⁵ S. 907, Section 2(a), proposing new Code 11(d)(2)(C).

⁶ S. 1040 only amends certain sections of Subtitle A of the Internal Revenue Code. As a result, Subchapter F, and the lobbying limitations contained therein, would remain in tact.

⁷ S. 1040, Section 102(b), amending Code Section 4977.

⁸ Retirement plan contributions include contributions "to or under any plan or arrangement which makes retirement distributions." S. 1040, Section 102(b), amending Code Section 4977(c)(3). This would appear to include contributions to both eligible and ineligible plans under Section 457.

repeal of certain contribution limits and nondiscrimination rules.⁹ The Specter proposal contains no such language.

Summary

One reason for the interest in the Flat Tax is its simplicity relative to current law and, in most respects, the other proposed alternatives.¹⁰ Of all the proposed tax systems, the Flat Tax seems to have the least impact on associations. However, because the Shelby proposal eliminates the charitable contribution deduction, this proposal may have a major impact on philanthropic organizations, related foundations, and 501(c)(3) membership organizations.¹¹ Other than the 17 percent tax on noncash compensation under the Shelby proposal, the direct tax impact of the Shelby and Specter Flat Tax proposals on 501(c)(4) and 501(c)(6) associations should be minimal. The impact on associations' external environment would be quite another matter, beyond the scope of this report.

⁹ S. 1040, Section 103(a).

¹⁰ This assumes that the Specter Proposal is intended to exempt the same types of organizations exempt from tax under the current provisions.

¹¹ The Shelby proposal repeals the Internal Revenue Code, including the current provisions relating to the charitable contribution deduction.

Associations and the Simplified USA Tax

The Simplified Unlimited Savings Allowance (USA) Tax would impose an 8 percent tax on the first \$150,000 of "gross profits" and 12 percent on "gross profits" over \$150,000.¹² In general, gross profits are computed by subtracting the cost of business purchases from taxable receipts. Business purchases exclude a number of items, the most important of which are employee compensation and benefits.¹³ The simplified USA tax bite is softened by a payroll tax credit equal to the employer's share of FICA tax.

Tax Exemption

The Simplified USA Tax would maintain the treatment of associations currently exempt from tax under Sections 501(c)(6) and 501(c)(4).¹⁴ The treatment of membership associations exempt under Section 501(c)(3) is not nearly so clear-cut. Exemption would be denied to a Section 501(c)(3) organization that devotes a substantial amount of funds to the following activities:

1. Conducting seminars and other similar programs,
2. conducting research to educate Congress or the general public about policy issues,
3. producing books and pamphlets, or
4. a combination of the foregoing.¹⁵

Since these activities generally represent the major program expenditures for most Section 501(c)(3) membership associations, their exemption from the Simplified USA Tax is highly doubtful. However, there is no indication that such associations would be barred from receiving exemption under the rules applicable to 501(c)(6) organizations.¹⁶

Taxable Receipts

As discussed above, many Section 501(c)(3) organizations, absent qualification for exemption as a (c)(6) association, could face taxation in the same manner as any other business. Such an organization would be taxed on all receipts from the sale of property, use of property, and

¹² H.R. 269, Title III, proposing new Code Section 201(b).

¹³ H.R. 269, Title III, proposing new Code Section 205(a)(3) and (4).

¹⁴ H.R. 269, Title III, proposing new Code Sections 253(a), (b) and (c).

¹⁵ H.R. 269, Title III, proposing new Code Section 253(i).

¹⁶ The restrictions imposed by H.R. 269, Title III, proposing new Code Section 253(i) are limited to educational organizations seeking exemption under new Section 253(c)(3) and does not mention organizations seeking exemption under any other subsection.

performance of services in the United States.¹⁷ This category of receipts would include what is presently exempt function program service revenue. One can only assume that the definition of taxable receipts would also include dues received in exchange for other member services that are not priced separately.

Business Purchases

Examples of typical business purchases that associations could subtract from taxable receipts in computing their gross profits would include:

1. The purchase or rental of real property or capital equipment,
2. the purchase of supplies and inventory and,
3. the purchase of services from independent contractors.¹⁸

Payroll Tax Credit

The payroll tax credit for a business entity is the employer's share of the FICA tax, equal to 7.65 percent of the first \$87,900 of wages plus 1.45 percent of the wages over the \$87,900 base for 2004. The payroll tax credit may not exceed the current year's tax but may be carried over to future years up to a maximum of 15 years.¹⁹

Illustration – Association Formerly Exempt Under Section 501(c)(3)

Facts: An association has a \$5,000,000 annual operating budget. The association conducts five major programs – publications, government affairs, a trade show, educational conferences, and industry promotion. Other sources of revenue include advertising, sponsorship, and an administrative fee charged to the association's related foundation. The publication and government affairs programs are provided to the members in exchange for dues. The association charges separate fees for the trade show and tuition for the educational conferences. All employee salaries fall below the Social Security wage base (currently \$87,900). The impact of the Simplified USA Tax on the association's operations would be as follows:

¹⁷ H.R. 269, Title III, proposing new Code Section 203(a).

¹⁸ H.R. 269, Title III, proposing new Code Section 205(a)(2).

¹⁹ H.R. 269, Title III, proposing new Code Sections 282(a), and 283(a).

| | <i>Annual Operations</i> | <i>Gross Profit</i> | <i>Nontaxable/ Nondeductible</i> |
|-------------------------------------|------------------------------|-------------------------|--------------------------------------|
| Revenue | | | |
| Dues | 2,000,000 | 2,000,000 | |
| Trade show | 1,000,000 | 1,000,000 | |
| Educational conferences | 900,000 | 900,000 | |
| Advertising | 600,000 | 600,000 | |
| Sponsorship | 300,000 | 300,000 | |
| Administrative fee | 200,000 | 200,000 | |
| Total revenue | 5,000,000 | 5,000,000 | |
| Expense | | | |
| Salaries (all below the FICA limit) | 2,000,000 | | 2,000,000 |
| Travel, lodging, meals | 800,000 | 800,000 | |
| Consultants | 700,000 | 700,000 | |
| Occupancy | 600,000 | 600,000 | |
| Employee benefits | 500,000 | | 500,000 |
| Printing | 400,000 | 400,000 | |
| Total expenses | 5,000,000 | 2,500,000 | 2,500,000 |
| Taxable (creditable) amount | | 2,500,000 | (2,000,000) |
| <i>Taxes at 8% and 12%</i> | | <i>\$294,000</i> | |
| <i>Payroll tax credit at 7.65%</i> | | <i>(153,000)</i> | |
| NET TAX | | \$141,000 | |

Analysis of Taxable Receipts: Taxable receipts would include all receipts from the sale of property, use of property, and performance of services in the United States. This category of receipts covers most program service and dues revenue. Whether or not sponsorship receipts would be considered taxable is unclear since the proposal eliminates tax exemption for certain associations altogether.

Analysis of Business Purchases: Deductible business purchases would generally include the acquisition of property and, the use of property or services. However, personnel and most employee benefit costs would be excluded from the definition of business purchases.

Summary

The Simplified USA Tax would maintain many aspects of the current tax treatment of associations. However, the potential exists for membership associations seeking exemption under (c)(3) to be treated like any other business. With no tax-exempt status to protect, a (c)(3) membership association would be free to conduct any unrelated business activity it chooses without IRS intercession, at a manageable tax cost. The chief drawback of the Simplified USA Tax proposal is that it lacks the simplicity of the Flat Tax proposal and might in the final analysis be as complex as our present income tax system.

Associations and the National Retail Sales Tax

Of the various types of consumption tax proposals, the National Retail Sales Tax (NRST) should be the easiest to understand, since it adopts standard rules already in existence for state sales taxes. Retail sales taxes are levied by 45 states and by numerous local jurisdictions on purchases of certain goods or services by associations.²⁰ The proposed NRST would be administered primarily by the states in return for a reasonable administration fee.²¹ Both the Tauzin proposal and the Linder proposal virtually eliminate the income tax system, as we know it today.

As introduced, the Tauzin NRST would impose a 15% tax on gross payments for the use, consumption, or enjoyment in the United States of any taxable property or service, whether produced or rendered within or without the United States.²² The Linder proposal would levy a NRST on gross payments for the use or consumption in the United States of any property, excluding intangible and used property, or service.²³ The Linder proposal would impose tax at a rate of 23% for 2005 and a combination of the general revenue rate (14.91%), the old-age, survivors, and disability insurance rate (Social Security rate), and the hospital insurance rate (Medicare rate) for years after 2005.²⁴

Tax Exemption

The Tauzin and Linder proposals both exempt dues, contributions, and payments to qualified not-for-profit organizations.²⁵ Thus, an association would not be required to collect tax on revenue that is substantially related to its tax-exempt purpose. However, associations would be required to collect and remit the tax on revenue from unrelated business activities.²⁶

The most prominent issue for associations however is the liability for the payment of tax on property and services that are *purchased*. One noteworthy provision of the NRST is that if an association provides taxable property or services in connection with contributions or dues

²⁰ Some associations exempt under section 501(c)(3) have received sales tax exemptions in certain jurisdictions. However, the majority of membership associations remain subject to the sales tax provisions in most states.

²¹ H.R. 4168, Section 4, proposing new Code Section 31 and H.R. 25, Section 201, proposing new Code Section 401.

²² H.R. 4168, Section 4, proposing new Code Section 1(a).

²³ H.R. 25, Section 201, proposing new Code Section 101(a) and (b) and Section 2(a)(14).

²⁴ H.R. 25, Section 201, proposing new Code Section 101(b).

²⁵ H.R. 4168, Section 4, proposing new Code Section 3(a)(2) and H.R. 25, Section 201, proposing new Code Section 706(a) and (d). H.R. 4168, Section 4, proposing new Code Section 3(a)(2)(C)(v) and H.R. 25, Section 201, proposing new Code Section 706(b)(5) include associations in the definition of qualified not-for-profit organizations.

received, then it must pay the tax on the fair market value of such taxable property or services.²⁷ Some associations could therefore be liable for the payment of tax on nonexempt purchases and, as discussed above, have the responsibility for collection and remittance of taxes as a provider of taxable property or services. Thus, associations must be aware of both the expenditure and collection features of the NRST.

Taxable Purchases

All purchases other than exempt purchases described above would be taxable purchases subject to the payment of tax by the association. Exempt purchases include those that are used to produce or sell taxable property or services. A central question for associations therefore is the extent to which association purchases will be considered exempt purchases. If a purchase is not used in the production or sale of taxable property or services (i.e. a taxable sale), then the purchase is nonexempt and the association must pay the tax.

Exempt Purchases

If the association uses the purchased property or services in the production or sale of other taxable property or services in the ordinary course of an *active trade or business*, the expenditure is exempt.²⁸ Although the proposed legislation does not define an active trade or business, it appears that, under the Tauzin NRST, associations would be deemed to be so engaged, if the property or service provided is not substantially related to the association's exempt purpose or is commercially available.²⁹ Because the Linder proposal does not offer comparable language, the same determination cannot be made under this NRST.

Association Dues

The payment of dues or contributions to an association will generally not result in a transaction subject to tax. However, as discussed above, associations that provide property or personal services in exchange for dues or contributions will be deemed to have *provided a taxable*

²⁶ H.R. 4168, Section 4, proposing new Code Section 1(c) and H.R. 25, Section 201, proposing new Code Section 103(a).

²⁷ H.R. 4168, Section 4, proposing new Code Section 3(a)(2)(E) and H.R. 25, Section 201, proposing new Code Section 706(d).

²⁸ H.R. 4168, Section 4, proposing new Code Section 21(e)(1) and H.R. 25, Section 201, proposing new Code Section 2(a)(8)(A) provide that a property or service is purchased to produce a taxable property or service if such property or service is purchased by a person in an active trade or business for the purpose of employing or using such property or services in the ordinary course of that active trade or business.

²⁹ H.R. 4168, Section 4, proposing new Code Section 3(a)(2)(B).

purchase at the fair market value of the property or services purchased.³⁰ This would include, for example, an association's payments for a government affairs or industry promotion program that is provided to members in exchange for dues. In these situations, the association would be required to pay the tax.

Education and Research Activities

The Tauzin and Linder NRST proposals provide an exemption for education, training, research, experimentation, testing, and development.³¹ Associations will not be deemed to have made a taxable purchase in connection with such activities, and would not be required to pay sales tax.³²

Purchases For Resale

A property or service is purchased for resale if it is purchased for the purposes of reselling the taxable property or service in the ordinary course of an active trade or business.³³ Sales generated in an unrelated business activity would likely be considered an active trade or business and the association would not be liable for tax on related purchases.

Exports From the United States

Property or services exported from the United States for use, consumption, or enjoyment outside of the United States is also exempt from tax.³⁴ Thus, it appears that associations would not be required to pay tax on purchases for conferences, trade shows, etc. held outside of the United States. The term 'United States' means the 50 States, the District of Columbia, and any commonwealth, territory or possession of the United States.³⁵

³⁰ H.R. 4168, Section 4, proposing new Code Section 3(a)(2)(E) and H.R. 25, Section 201, proposing new Code Section 706(d). In other words, the member would be deemed to have made a taxable purchase upon which the association would be responsible for the collection and remittance of the tax.

³¹ H.R. 4168, Section 4, proposing new Code Section 21(e)(4) and H.R. 25, Section 201, proposing new Code Section 2(a)(8)(B) and (D).

³² The association would pay the tax on its tuition-related expenditures (purchases) because such expenditures would not have been used in the production or sale of a taxable service. Accordingly, the consumer of the educational service would not be required to pay a tax on the tuition, and the association would have no responsibility to collect and remit the tax.

³³ H.R. 4168, Section 4, proposing new Code Section 2(a) and (b)(1) and H.R. 25, Section 201, proposing new Code Section 102(a)(1)(A) and (b)(1).

³⁴ H.R. 4168, Section 4, proposing new Code Section 2(a)(2) and H.R. 25, Section 201, proposing new Code Section 102(a)(1)(B).

³⁵ H.R. 4168, Section 4, proposing new Code Section 21(o) and H.R. 25, Section 201, proposing new Code Section 2(a)(15).

Other Aspects of the NRST

Hobby Activities: Associations would not be required to collect and remit the tax on otherwise taxable sales if the trade or business activity is not engaged in for profit. An activity is considered to be engaged in for profit only if the gross payments received exceed the sum of taxable property and services purchased, wages paid, and taxes paid.³⁶ If the activity were not deemed to be engaged in for profit, then the association would be required to pay the tax on the purchases used in the hobby activity.

Taxable Services: Taxable services include wages paid by an employer (including government employers) not engaged in an active trade or business unless paid by a qualified not-for-profit organization.³⁷

Affiliated Firms: Purchases and sales between organizations that are 50 percent or more owned are generally exempt.³⁸ Presumably then, an association-related foundation or for-profit subsidiary would not be required to pay tax on property or services purchased from the related association, or vice versa.

State Taxes: The proposed legislation provides for a conforming state sales tax on essentially the same basis as the NRST.³⁹

Illustration

Facts: An association has a \$5,000,000 annual operating budget. The association conducts five major programs – publications, government affairs, a trade show, educational conferences, and industry promotion. Other sources of revenue include advertising, sponsorship, and an administrative fee charged to the association's related foundation. The publication and government affairs programs are provided to the members in exchange for dues. The association charges separate fees for the trade show and tuition for the educational conferences. Expenses are allocated by function to major programs and supporting services. Wages totaling \$2,000,000 are assumed to be allocated ratably to each of the association's programs and supporting

³⁶ H.R. 4168, Section 4, proposing new Code Section 57(b) and H.R. 25, Section 201, proposing new Code Section 701(b).

³⁷ H.R. 4168, Section 4, proposing new Code Section 21(n)(2) and H.R. 25, Section 201, proposing new Code Section 2(a)(12) and (14)(B).

³⁸ H.R. 4168, Section 4, proposing new Code Section 2(e). H.R. 25, Section 201, proposing new Code Section 103(g) provides exemption from the collection and remittance requirements for purchases from an affiliated firm (greater than 50% ownership) if such purchases are exempt under new Code Section 102 (business purpose, export, etc.).

³⁹ H.R. 4168, Section 4, proposing new Code Section 31(c) and H.R. 25, Section 201, proposing new Code Section 401(b)(1).

services such that each functional expense category includes a 40 percent salary allocation. The impact of the Tausin NRST on the association's operations would be as follows:

| | <i>Annual Operations</i> | <i>Taxable Purchases</i> | <i>Taxable Sales</i> | <i>Exempt Sales</i> |
|---|------------------------------|------------------------------|--------------------------|-------------------------|
| Revenue | | | | |
| Dues | 2,000,000 | | | 2,000,000 |
| Trade show | 1,000,000 | | | 1,000,000 |
| Educational conferences | 900,000 | | | 900,000 |
| Advertising | 600,000 | | 600,000 | |
| Sponsorship | 300,000 | | | 300,000 |
| Administrative fee | 200,000 | | | 200,000 |
| Total revenue | 5,000,000 | | 600,000 | 4,400,000 |
| Functional expenditures⁴⁰ | | | | |
| Publications | 900,000 | 540,000 | | |
| Government affairs | 800,000 | 480,000 | | |
| Trade show | 700,000 | 420,000 | | |
| Education | 600,000 | | | |
| Industry promotion | 500,000 | 300,000 | | |
| Total programs | 3,500,000 | 1,740,000 | | |
| Management & general | 900,000 | 540,000 | | |
| Membership development | 500,000 | 300,000 | | |
| Fund raising | 100,000 | 60,000 | | |
| Total supporting services | 1,500,000 | 900,000 | | |
| Total expenditures | 5,000,000 | 2,640,000 | | |
| Taxes at 15%: | | | | |
| NRST paid | | \$396,000 | | |
| NRST collected & remitted | | | \$90,000 | |

⁴⁰ The type of expenses (by object) comprising the functional expenditures are:

| | |
|-------------------------|--------------------|
| Salaries (40% of total) | \$2,000,000 |
| Travel, lodging, meals | 800,000 |
| Consultants | 700,000 |
| Occupancy | 600,000 |
| Employee benefits | 500,000 |
| Printing | 400,000 |
| Total expenses | \$5,000,000 |

Analysis of Taxable Sales: Taxable sales include those products and services that are unrelated to the association's tax-exempt purpose; therefore, the association must collect a sales tax on the gross advertising revenue.

Analysis of Exempt Sales: Except for the advertising revenue, all other revenue is related to the association's tax-exempt purpose and would therefore be exempt from the imposition of tax.

Analysis of Taxable Purchases: Taxable purchases include the costs of providing member services other than wages (assumed to be 40% of purchases) in connection with dues or other payments received and which are related to the association's tax-exempt purpose. Since the education related expense is specifically exempted from tax, the association does not have to pay sales tax on such purchases. Similarly, the costs of supporting services required to operate the association, but which are not directly related to the production or sale of taxable property or services would likely be considered taxable purchases.⁴¹

Summary

The recent NRST proposals would likely require associations to collect and remit sales tax on the sale of taxable property and services. However, the majority of association revenue would be not be considered taxable sales. The greatest cost under the proposed NRST is the taxation of association programs. The economic effect of passing the tax along to members and nonmembers means that the associations programs may be less affordable. Although proponents of the NRST may argue that the consumers of association products will be more willing to pay a higher price for goods and services because of reduced tax burden for their business.⁴² As the discussion continues, associations must answer these and other questions that will affect their operations.

⁴¹ The proposed legislation does not make clear to what extent overhead costs would be allocated between exempt and nonexempt purchases.

⁴² The NRST rates under the Tausin and Lindler proposals are much lower than the maximum current income tax rates of 35%. However, it is extremely difficult to compare the after-tax income under the proposed NRST with the current income tax system.

Conclusion

All three of these most prominent tax restructuring proposals would affect associations in ways quite different from charitable organizations, and quite different from the impact on their business and professional members. The Flat Tax proposal would involve the least change for associations, whereas the Simplified USA Tax and National Retail Sales Tax would mean drastic overhaul of associations' tax picture.

The following table presents a comparison of the proposed changes, as they would affect associations' most significant tax considerations.

TABLE SUMMARY OF IMPACT OF TAX RESTRUCTURING PROPOSALS ON ASSOCIATIONS

| ISSUE | CURRENT LAW | FLAT TAX | SIMPLIFIED USA TAX | RETAIL SALES TAX |
|--|--|--|---|--|
| Associations Exempt From Income Tax | Educational 501(c)(3) Social Welfare 501(c)(4) Trade 501(c)(6) | Educational 501(c)(3) Social Welfare 501(c)(4) Trade 501(c)(6) | <u>Exempt:</u> Educational 501(c)(3) Social Welfare 501(c)(4) Trade 501(c)(6) <u>Taxable:</u> Certain 501(c)(3)s | Taxable |
| Rate of Tax | Up to 35% if UBIT | 17% or 20% | 8%/12% with an offsetting payroll credit of 7.65% | 15% or 23% |
| Taxability of Investment Income | Generally Exempt | Exempt | Exempt | Exempt |
| Taxability of Related Program Service Revenue | Exempt | Exempt | Exempt for certain 501(c)(3) Taxable for all others | Exempt |
| Taxability of Dues | Exempt | Exempt | Taxable for certain 501(c)(3)s Exempt for all others | Exempt |
| Deductibility of Members Dues | Generally deductible subject to IRC 162 | Probably deductible for businesses but not for individuals | Probably deductible for businesses but not for individuals | Should not be a taxable to the member if related to business purpose |
| Treatment of Program Service Expenditures | Nondeductible | Nondeductible | Deductible | Taxable if used to provide taxable products or services |
| Deductibility of Charitable Contributions | Deductible if contributed to a 501(c)(3) | Nondeductible | Deductible for Individuals but not for businesses | No applicable deduction |



1700 N. Moore Street, Suite 2250, Arlington, VA 22209

PRESIDENT'S ADVISORY
FAX: 703-841-1184
PANEL
email: info@retail-leaders.org www.retail-leaders.org
ON FEDERAL TAX REFORM

2005 MAR 28 P 6: 04

March 17, 2005

Senator Connie Mack
Senator John Breau
The President's Advisory Panel on Federal Tax Reform
1440 New York Avenue, N.W., Suite 2100
Washington, DC 20220

Dear Senators Mack and Breau:

The Retail Industry leaders association is pleased to have the opportunity to make comments regarding the President's Advisory Panel on Federal Tax Reform. The Retail Industry Leaders Association (RILA) represents the nation's most successful and innovative retailer and supplier companies – the leaders of the retail industry. Retail is the second largest industry in the U.S., with \$3.8 trillion in annual sales. Our employees represent 12 percent of our nation's workforce. RILA member retailers and suppliers operate 100,000 stores, manufacturing facilities and distribution centers throughout every congressional district in every state, as well as internationally.

You asked for very specific comments from interested parties and I am happy to provide you with comments regarding each of the four points raised in your request.

I. Headaches, unnecessary complexity, and burdens that taxpayers - both individuals and businesses - face because of the existing system.

The corporate alternative minimum tax (AMT) also places an undue burden on business. The administrative and time-consuming burdens of having to calculate tax liability under both the corporate income tax and the corporate AMT can be costly, particularly in a tight margin sector like retail. It can also be difficult to use AMT credits in future years.

II. Aspects of the tax system that are unfair.

Retailers often argue that the depreciable life of an asset exceeds its economic life. Retailers say that current law forces them to depreciate assets, including buildings and plant and equipment, long after they are useful. Many retailers would appreciate the ability to expense assets in the year they are placed into service, or at least, reduce the recovery period to better reflect economic reality.

III. Specific examples of how the tax code distorts important business or personal decisions.

Retailers oppose the temporary and fleeting nature of specific expiring tax credits. For example, the Work Opportunity Tax Credit, and the Welfare-to-Work Tax Credit will sunset at the end of this year. Although there is widespread support in Congress to extend or make these incentives permanent, it is uncertain when this will be accomplished. These programs help many retailers offset the added costs of hiring and training people who have been on public assistance programs. These programs have helped thousands of disadvantaged individuals find meaningful employment in retail and other settings. They are important tools in efforts by retailers to help needy individuals become productive employees. The uncertainty makes it difficult for companies to plan and make decisions that, in turn, create distortions within the economy.

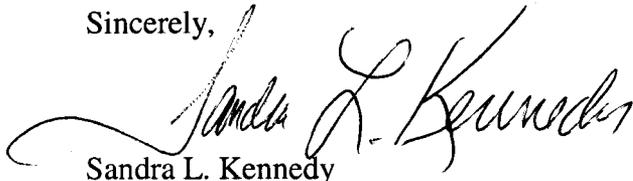
IV. Goals that the Panel should try to achieve as it evaluates the existing tax system and recommends options for reform.

The retail industry has not yet presented a unified view on specific proposals for tax reform. Different reforms would affect consumer business companies, even those selling similar products, in myriad ways and internal cultures have significant effects on corporations willingness to comment on specific proposals. Retailers strongly oppose a national retail sales tax and similar consumption-based tax systems, which have the potential for depressing spending - at least in the short term - as consumers and taxpayers react to sudden, significant price increases. Retailers would also have to collect such taxes, which could add to administrative burdens. Retailers are especially adept at moving quickly to adapt to changes in the market. While they quickly deal with sudden and frequent changes in the tax code, it does not mean they like them. They, and other businesses, would benefit from a fair and consistent tax system that they can count on.

RILA does not envy the mandate of the panel. You are tasked with proposing tax reforms that are at once lofty and idealistic as well as enforceable and politically palatable. Whatever the panel proposes must be enacted by the U.S. Congress. Much of what is done in this Congress may be undone by subsequent Congresses. However, we have faith in the panel's ability to propose tax reforms that embody the principles of fairness, simplicity, accountability, and transparency.

We stand ready to assist the panel in any way we can and very much look forward to the panel's recommendations to the Treasury Secretary,

Sincerely,



Sandra L. Kennedy
President, RILA



2005 MAR 28 P 5:24

Marc E. Lackritz
President

March 17, 2005

President's Advisory Panel on Federal Tax Reform
1440 New York Avenue, N.W., #2100
Washington, D.C. 20220

Dear Members of the President's Advisory Panel on Federal Tax Reform:

On behalf of the Securities Industry Association¹, I am pleased to submit the following in response to the Panel's February 16, 2005 request for public comments. We applaud the Panel's efforts to identify unnecessary distortions, inefficiencies, and complexity in the current system as a precursor to exploring possible reform models.

SIA's comments are focused on four major areas: the importance of reducing distortions in the corporate tax code; the distortions caused by the temporary nature of the current law provision allowing deferral of active financial services income; complexities that drive down national savings; and the importance of reviewing any proposed reform / replacement system through a global prism.

I. DOUBLE-TAXATION AND OTHER DISTORTIONS IN THE CORPORATE TAX CODE:

By imposing multiple layers of taxation on corporate profits, the Tax Code distorts business behavior and decisions about business organization itself. In 2003, Congress reduced the distortions caused by the double-taxation of corporate profits by capping at 15% the top individual tax rate on dividends and long-term capital gains. As expected, this law has spurred more companies to offer larger dividends, enhanced the wealth of investors, and improved corporate governance by making businesses subject to the discipline of the dividend.

Those benefits, however, are limited by the temporary nature of the provision. In its recent "Budget Options" book, the Congressional Budget Office observed that:

¹ The Securities Industry Association brings together the shared interests of nearly 600 securities firms to accomplish common goals. SIA's primary mission is to build and maintain public trust and confidence in the securities markets. At its core: Commitment to Clarity, a commitment to openness and understanding as the guiding principles for all interactions between investors and the firms that serve them. SIA members (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. According to the Bureau of Labor Statistics, the U.S. securities industry employs nearly 800,000 individuals, and its personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. In 2004, the industry generated an estimated \$227.5 billion in domestic revenue and \$305 billion in global revenues. (More information about SIA is available at: www.sia.com.)

[The 2003 tax cut on dividends and long-term capital gains] mitigated those distortions by reducing the extra tax burden—but only for a short interval. Because the lower rates expire at the end of 2008, investments made after that time will not benefit from them at all, and many investments made between 2003 and 2008 will benefit only partially.... Hence, many of the gains in efficiency that could result from the effects of the lower rates on the allocation of investment will not be realized unless [the rates are] perceived to be permanent.

These distortions caused by double-taxation impose real costs on the economy and should be addressed in any recommendations made by the Panel. In addition, SIA notes that other countries have successfully attracted investment and spurred economic growth by enacting broad-based reductions in corporate income taxes and encourages the Advisory Panel to consider whether a similar, broad-based reduction in U.S. corporate tax rates would strengthen our economy.

II. DISTORTIONS CAUSED BY TEMPORARY RULES IMPACTING FINANCIAL SERVICES FIRMS COMPETING ABROAD:

Under current law, the active international income of foreign subsidiaries of American companies generally is not subject to U.S. tax until the funds are repatriated to the United States. This deferral is a long-standing, permanent feature of the Code for most businesses with international operations. It is correctly recognized as necessary to enable U.S.-based companies to compete with firms from countries with similar (or even more favorable) home country rules. The financial services industry, however, is uniquely disadvantaged, because the provision allowing deferral of their active income is only temporary. The current extension is set to expire at the end of 2006.

The temporary nature of current law injects costly distortions into firms' evaluations of business opportunities abroad and the resulting tax treatment of revenues from them, particularly with respect to multi-year transactions. Moreover, U.S.-based companies competing in international financial markets are selling a highly fungible commodity – money – and as a result find it particularly hard to make up elsewhere any tax costs that are not faced by their competitors.

III. SAVINGS RATE DRIVEN DOWN BY COMPLEXITY:

In providing advice and financial planning services, our industry is on the front-line helping Americans save and invest for the future. We are increasingly concerned about the inadequate savings levels in American households. In 2004, aggregate personal saving, measured by the Bureau of Economic Analysis, averaged about one percent of disposable income in 2004, more than six percentage points lower than the average that has prevailed since the early 1970s.

Tax policy has a significant impact on whether or not workers are saving. For example, in the 1970s, the Individual Retirement Account (IRA) was expanded to permit any worker to qualify for a deduction for contributions to an IRA. Participation skyrocketed with contributions growing from \$4.8 billion in 1981 to \$38.2 billion by

1985. However, when this universal incentive was taken away in 1986, contributions fell to 14.1 billion in 1987, down from \$37.8 billion in 1986.²

Income eligibility limits, an increasing number of special purpose savings vehicles, and complex rules and regulations hurt middle-income and lower-income Americans efforts to save. The dramatic decrease in IRA contributions post 1986 demonstrates that taxpayers will not save for long-term goals unless the rules are clear, consistent, and universal.

Low or negative savings rates depress economic growth. Low savings rates reduce the pool of capital available for investment, the source of job creation and growth. Increased individual savings would directly improve economic growth by increasing the investment capital available for businesses and lowering the cost of capital.

To stimulate savings, SIA encourages the Commission to consider bold steps to simplify the current savings landscape. President Bush has proposed to expand savings opportunities through the creation of Retirement Savings Accounts (RSAs), Lifetime Savings Accounts (LSAs), and Employer Retirement Savings Accounts (ERSAs). These programs would provide all Americans with an easy, tax-preferred way to save for short-term goals such as education or purchasing a first home, as well as the long-term needs of their retirement years. No longer would families have to decide how much to save in one of the plethora of special purpose accounts, only to determine later that they had not saved enough in the appropriate account.

Providing greater flexibility, clarify, and simplification will encourage more Americans to save, thus promoting retirement security and U.S. economic growth.

IV. REVIEWING REFORM PROPOSALS THROUGH A GLOBAL LENS

In its request for comments, the Panel asked for submissions on “goals that the panel should try to achieve....” Without commenting on any specific reform proposal that might be considered by the Panel, the SIA believes that a key goal must be to ensure that we have a Tax Code, and a system of administering it, that does not hinder the ability of financial services companies to compete at home and around the world.

In the past two decades, profits from international operations have come to represent an increasingly large share of the total income earned by financial services companies. We strongly urge the Panel to ensure that any reform plan, whether it consists of revisions to the current code or a wholesale re-writing, ensures that it creates a level playing field, both at home and abroad, for financial services firms and our customers

Thank you for your consideration of our views as you evaluate proposals to reform the Tax Code. We stand ready to provide further information to you or your staff on these or other matters of concern.

Sincerely,



Marc E. Lackritz
President
Securities Industry Association

² Investment Company Institute Perspective, February 2005, p. 4 & 5