Patterson Belknap

Tax-Exempt Organizations Alert
January 25, 2024

January 2024 Legislative Round Up

Recent bills in the U.S. House of Representatives and Senate demonstrate legislators' concerns about several issues related to nonprofits, including: (1) admissions practices at institutions of higher education; (2) cross-border grantmaking by U.S. nonprofit entities; (3) support of institutions of higher education by foreign sources; (4) institutions of higher education with large endowments; (5) professional sports leagues; (6) political activities of Section 501(c)(4) organizations; and (7) clarification of the meaning of federal financial assistance for Section 501(c), 501(d), and 401(a) organizations. This alert offers a high-level summary of each bill.

1. S. 3232: Merit-Based Admissions Practices as a Standard of Accreditation for Higher Education Institutions

S. 3232, the "Merit-based Educational Reforms and Institutional Transparency Act" or "MERIT Act," was introduced in the Senate by Senator Todd Young (R-IN) on November 7, 2023.

The Act is aimed at college admissions practices that grant preferential treatment to applicants with relationships to alumni and donors of institutions of higher education. The Act would amend Section 496(a)(5) of the Higher Education Act of 1965 to include an additional standard for accreditation of an institution of higher education. Under the additional standard, the institution must adopt admissions practices that refrain from "preferential treatment" in admissions based on an applicant's relationship to alumni of, or donors to, the institution. Preferential treatment is defined as "making an admissions decision or awarding tangible education benefits" where the applicant's relationship with an institution's alumni or donors is the "determinative factor." The Act clarifies that institutions may still consider the "demonstrated interest" of an applicant as a factor in admissions decisions if: (1) there are clearly defined and publicly available criteria for assessing an applicant's demonstrated interest; (2) the applicant has the opportunity to explain why they have a demonstrated interest in the institution, which may be informed by lived experiences, values, attributes, and faith; and (3) the opportunities to demonstrate interest are equally accessible to all applicants. The Act also provides for the Secretary of Education to explore the feasibility of working with the National Student Clearinghouse to collect and produce institutional data on the impact of an admissions decision based on an applicant's relationship with alumni of, or donors to, an institution of higher education.

2. H.R. 6408: Termination of Tax-Exempt Status for "Terrorist Supporting Organizations"

H.R. 6408 was introduced into the House by Representative David Kustoff (R-TN) on November 14,2023, and after two hearings and a mark-up session, it was reported by the House Committee on Ways and Means on December 19, 2023 for consideration by the whole chamber.

H.R. 6408 would expand current rules against terrorist organizations in Section 501(p) of the Internal Revenue Code to also apply to "terrorist supporting organizations." The new provision would suspend the tax-exempt status of terrorist supporting organizations, prohibit them from applying for tax-exempt status, and disallow charitable deductions for contributions to such organizations. A terrorist supporting organization is any organization that is designated by the IRS as having provided, within three years of the designation, more than de minimis material support and resources to a terrorist organization within the meaning of Section 501(p). Material support or resources is defined broadly to include any tangible or intangible property or service, including financial services, training, expert advice or assistance, facilities, or transportation.

Before designating an organization as a terrorist supporting organization, the IRS would be required to mail written notice to the organization. The organization would have 90 days to demonstrate to the satisfaction of the IRS that (i) it did not provide the alleged material support or resources to the terrorist organization(s) or (ii) it has made reasonable efforts to have such support or resources returned and certified in writing to the IRS that it will not provide any further support or resources to a

terrorist organization or terrorist supporting organization. Absent this demonstration, the organization would be designated as a "terrorist supporting organization" at the end of the 90-day period.

The period of suspension of a terrorist supporting organization would begin on the date the IRS designates the organization as a "terrorist supporting organization," and would terminate only when the IRS affirmatively rescinds such designation in certain narrow circumstances.

3. H.R. 5933: Disclosure of Foreign Funding and Contracts by Institutions of Higher Learning

H.R. 5933, the "Defending Education Transparency and Ending Rogue Regimes Engaging in Nefarious Transactions Act" or "DETERRENT Act," was introduced into the House by Representative Michelle Steel (R-CA) on October 11 and passed the House on December 6, 2023. The Act would amend Section 117 of the Higher Education Act of 1965 ("HEA") to promote greater transparency about certain higher educational institutions' gifts from and contracts with foreign sources, foreign countries of concern, and foreign entities of concern. While Section 117 of the HEA has required disclosure of foreign gifts for over 30 years, the DETERRENT Act would significantly expand Section 117 reporting requirements in response to concerns about growing foreign influence over colleges and universities.

A "foreign source" is defined as a foreign government, a legal entity created under foreign law, a legal entity substantially controlled by a foreign source, a natural person who is not a U.S. citizen, an agent of a foreign source, and an international organization. "Foreign countries of concern" are defined to include North Korea, China, Russia, and Iran, as well as any country that federal agencies determine to pose a threat to the national security or foreign policy of the U.S. "Foreign entities of concern" are defined as entities designated as foreign terrorist organizations and entities on the Specially Designated Nationals list managed by the U.S. Department of the Treasury.

The DETERRENT Act would generally apply to institutions of higher education that are subject to Title IV of the HEA and would alter the existing Section 117 reporting regime in several important ways:

i. Disclosures of Foreign Gifts and Contracts— Institutions must file an annual disclosure report to the U.S. Secretary of Education regarding gifts from or contracts with foreign sources of at least $50,000, a significantly lower amount than the current $250,000 threshold for reporting. The threshold is further lowered to $0 for reporting gifts from or contracts with a foreign country of concern or foreign entity of concern. Institutions must also disclose names and addresses of foreign donors, the intended use of the gift or contract, and gifts to and contracts with affiliated entities such as university foundations. The Act also requires a compliance officer of the institution to personally certify the accuracy of the reports, which would be publicly available on the Education Department's website.

ii. Prohibition on Certain Contracts— Institutions are prohibited from entering into a contract with a foreign country of concern or foreign entity of concern unless it applies for and receives a one-year waiver from the Education Department for each year of the contract.

iii. Foreign Gifts and Contracts to Faculty and Staff—Research faculty and staff at institutions that (i) receive more than $50 million in federal funds in any of the previous five calendar years to support research and development or (ii) receive Title IV funds for federal financial aid must report to the institution any gifts from or contracts with a foreign source above certain monetary thresholds or with an undetermined monetary value, as well as any contracts with a foreign country of concern or foreign entity of concern, regardless of value. The institution must make information from these reports publicly available on its website.

iv. Investment Disclosure Report—Non-public institutions that have either more than $6 billion in assets or hold more than $250 million in "investments of concern" must file an annual disclosure report with the Secretary of Education when the institution or a related organization purchases, sells, or holds (directly or indirectly through any chain of ownership)

one or more "investments of concern." Investments of concern are defined as any equity, debt, contract, or derivative interest with respect to a foreign country of concern or foreign entity of concern. Funds acquired through a regulated investment company, exchange traded fund, or any other pooled investment are treated as acquired through a chain of ownership for purposes of reporting obligations. These reports would be publicly available on the Education Department's website.

If an institution were to fail to comply with any of these requirements for three consecutive fiscal years, it would become ineligible to participate in Title IV federal student assistance programs for at least two years. In addition, if an institution is found to be in willful violation after an Education Department investigation and subsequent court order, it would be required to pay the full cost of the court fees as well as financial penalties that escalate with repeated violations.

4. S. 3465: Excise Tax on Certain Large Private College and University Endowments

S. 3465, the "Woke Endowment Security Tax Act of 2023" or "WEST Act" was introduced into the Senate by Senator Tom Cotton (R-AR) on December 12, 2023 and would add a new Section 4969 to the Internal Revenue Code to impose a one-time excise tax on ten higher education institutions. The proposed new section would subject "specified applicable educational institutions" to an excise tax of 6% of the aggregate fair market value of the institution's assets at the end of the preceding tax year. This new excise tax would be in addition to the Section 4968 excise tax that was added to the Internal Revenue Code as part of the Tax Cuts and Jobs Act of 2017, which already requires certain private colleges and universities to pay an annual 1.4% excise tax on their total net investment income.

The Act defines "specified applicable educational institutions" as (i) any non-religious educational institution that has at least $12.2 billion in its endowment at the end of the preceding taxable year, and (ii) any non-religious educational institution that has at least $9 billion in its endowment and that operates a college on behalf of a State. The Act is targeted to apply to the following universities: Harvard, Yale, Stanford, Princeton, Massachusetts Institute of Technology, University of Pennsylvania, Northwestern, Columbia, Washington University, and Cornell, and aims to raise an estimated $15.47 billion of revenue to be used to support Israel's war against Hamas, Ukraine's war against Russia, and efforts to secure the southern U.S. border.

5. H.R. 6774: Special Rules for Professional Sports Leagues

H.R. 6774 was introduced into the House by Representative Mike Thompson (D-CA) on December 13, 2023, and would make certain professional sports leagues ineligible for federal income tax exemption under Section 501(c)(6) of the Internal Revenue Code. The bill is targeted at the proposed merger of the Professional Golfers' Association (PGA), and LIV Golf, a venture backed by the Saudi Public Investment Fund, Saudi Arabia's sovereign wealth fund.

H.R. 6774 would disqualify a professional sports league, organization, or association that engages in fostering national or international professional sports competitions as a substantial activity from Section 501(c)(6) tax-exempt status for any taxable year in which it has annual gross receipts in excess of $1 billion during any of the five preceding taxable years.

6. H.R.6913: Openness in Political Expenditures Now Act

H.R. 6913, the "Openness in Political Expenditures Now Act" or "OPEN Act" was re-introduced into the House by Representative Matt Cartwright (D-PA) on January 5, 2024, after failing to pass in previous Congresses.

The Act would amend the Internal Revenue Code to cap the amount of political spending of Section 501(c)(4) social welfare organizations. In particular, an organization would not be eligible for federal income tax exemption under Section 501(c)(4) if its total expenditures for certain political activities exceeds the lesser of (i) 10% of the organization's total expenditures for the taxable year or (ii) $10 million dollars. The Act would also require Section 501(c)(4) organizations to include this limitation in their governing instruments.

The Act would also amend the Federal Election Campaign Act of 1971 by adding a new requirement for corporations that submit regular, periodic reports to its shareholders to also disclose information about their political expenditures that exceed certain thresholds.

7. H.R. 7027: Clarification of the Meaning of Federal Financial Assistance for 501(c), 501(d), and 401(a) Organizations

H.R. 7027, the "Safeguarding Charity Act," was introduced in the House by Representative W. Gregory Steube (R-FL) on January 17, 2024. Senator Marco Rubio (R-FL) introduced a companion bill in the Senate.

The Act was introduced in response to two recent federal court rulings that the Section 501(c)(3) tax-exempt status of private schools constituted the receipt of federal financial assistance, thereby causing them to be subject to Title IX prohibitions on sex-based discrimination in education. The Act seeks to prevent religious schools and other nonprofits from being subject to certain federal regulations by clarifying that tax-exempt organizations would not be treated as recipients of federal financial assistance by virtue of their federal tax exemption. In particular, the Act would amend Title 1 of the United States Code, which provides the rules of construction applicable to all federal laws, by adding a new section to clarify that the term "federal financial assistance" does not include any exemption from federal income tax for organizations described in Section 501(c), Section 501(d) (religious and apostolic organizations), or Section 401(a) (qualified trusts) of the Internal Revenue Code.

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We will continue to monitor these bills as they move through Congress.

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