

# Nonprofits Could Face a Taxing Time

*Ways and Means panel report recommends broad tax changes, including heavier levies on journal advertising revenue*

CONGRESS IS CONSIDERING changes in tax law that could drastically trim the deductions tax-exempt organizations can claim. Bad news for nonprofit scientific societies which rely on advertising revenue from journals is a proposal to make a much larger portion of such income taxable.

The proposed change has drawn vigorous opposition because it would not simply put nonprofits on an equal footing with commercial publishers but would actually grant the latter a major competitive advantage. Were the new rule to go into effect, taxes on the ad revenue of nonprofits would be computed in a way that, for example, would cost *Science* an additional \$2 million a year; for-profit publishers would not be affected.

Under scrutiny are the rules governing so-called unrelated business income tax (UBIT) of groups which have nonprofit status for the scientific, educational, and professional purposes they serve. Unrelated business income is defined as income not derived from activities substantially related to an organization's exempt purpose.

Other activities on the list for tougher tax treatment include hospital and museum giftshops, university bookstores, and catalog and mail order services operated by tax-exempt organizations. Also targeted are fitness, exercise, and similar health-promotion activities, travel and tour services, hotel facilities, and affinity credit cards and other merchandising ventures of nonprofits. Royalties and interest received by nonprofits are likewise being examined.

The draft recommendations came out of a review of the tax treatment of income producing operations of nonprofit organizations by the House Ways and Committee's oversight subcommittee chaired by Representative Jake Pickle (D-TX). Action that would result in statutory change is considered unlikely this year because the subcommittee has yet to vote on the proposals and the matter has not been considered in the Senate. There is wide agreement, however, that the recommendations are likely to surface in the next Congress in similar form.

What inspired the review? Hill staff say that Ways and Means chairman Dan Rostenkowski (D-IL) was prompted to call for

a hard look at UBIT because its provisions had not been closely examined for many years. The federal deficit has heightened congressional interest in all potential sources of revenue. The notoriety gained recently by some television ministries directed attention to their large, tax-exempt operations. Most observers agree, however, that the strongest push has come from small business—a broadly based constituency with an increasingly effective lobby in Washington. Small business is resentful of what it sees as expanding competition from the nonprofit sector.

In respect to advertising revenue, the proposal is to limit deductions from advertising income to the direct costs of advertising—fees charged by an advertising agency for selling ads and the costs of preparing ads for publication, for example. Nonprofits would no longer be permitted to deduct editorial costs, as is now permitted. Ad revenue would presumably be taxed at the regular corporate rate of 34%. Critics of the proposal note that commercial publishers are able to deduct full editorial costs.

The changes would have a major impact on nonprofits with publishing operations. For some smaller tax-exempt organizations, advertising makes a publications program possible. Many larger nonprofits like AAAS use advertising revenues to defray part of the cost of their general programs.

The financial implications for AAAS illustrate the potential effect on scientific societies with large publishing programs. *Science* earned about \$12 million in ad revenue last year, the largest single source of income for the total \$29-million revenue

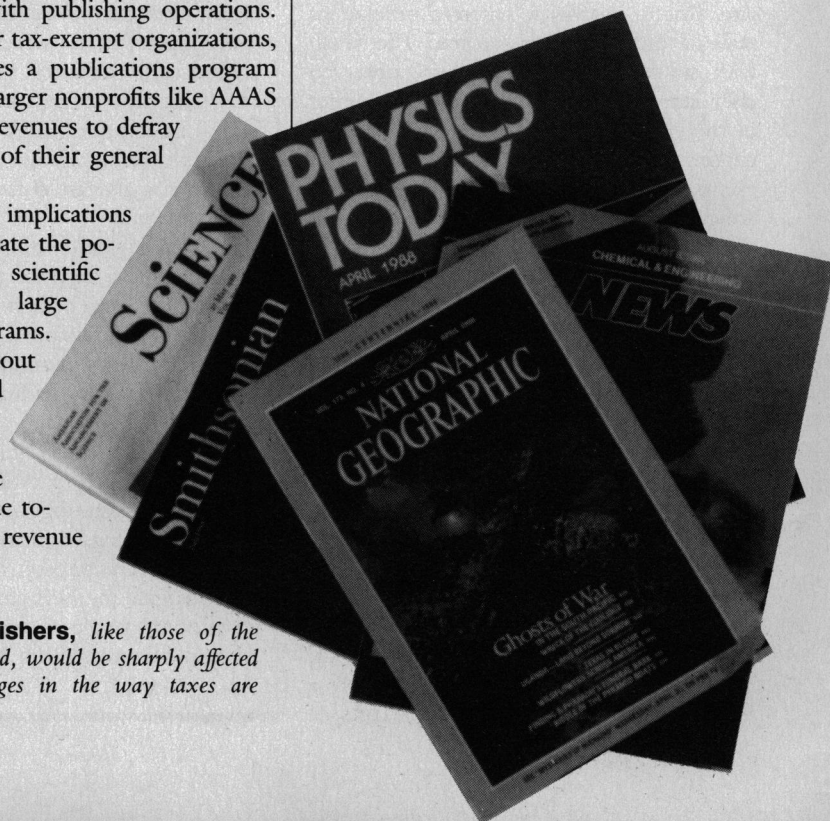
of the parent organization. Member dues was next at \$8 million. About \$6 million of the ad revenue went to pay the direct cost of selling advertising; the other \$6 million helped finance the editorial content of *Science*, which operated on a total budget of \$14 million. Taxation of the \$6 million at the corporate tax rate of 34% would mean \$2 million less in available funds. AAAS executive officer Alvin W. Trivelpiece says that such a cut would obviously have a heavy impact on the budgets of *Science* and other AAAS programs.

For other groups, a change in the tax treatment of advertising revenue could have far-reaching effects. The controller of the Institute of Electrical and Electronics Engineers (IEEE), suggested that the losses incurred by the imposition of this tax could force the IEEE to reexamine its nonprofit status.

Some association executives see cause for concern beyond the specific proposals. A. F. Spilhaus, Jr., executive director of the American Geophysical Union, says, "We're looking at a long-term trend toward more taxation of the activities" of tax-exempt organizations, which he sees as "more serious than the issue of ad revenue."

The recommendation not to allow nonprofit publishers to offset ad revenue against editorial costs in the House subcommittee draft was based on a finding that the legislative intent of Congress toward treatment of ad revenue was not clear. Therefore "to avoid uncertainty and controversy and continued litigation," the report recommended adoption of a rule that advertising income per se should be treated as income derived

**Nonprofit publishers, like those of the publications pictured, would be sharply affected by proposed changes in the way taxes are computed.**



from an unrelated business. According to staff sources, the legislators' underlying rationale was a belief that journal publishers would find a way to disseminate the "reader-ship content" anyway, a belief that the publishers are likely to dispute.

The law on unrelated business income tax dates from 1950. It was explicitly designed to deny an unfair advantage to nonprofit organizations that use their tax-exempt status to compete with businesses required to pay taxes; a whole UBIT canon has been constructed over the years.

The standard from the start has been the "relatedness" of these activities to a nonprofit's tax-exempt purposes. This test survived attempts during the review to change it to "inherently commercial," a change that would have sharply narrowed the range of permissible activities. According to an analysis of the draft report by Walter B. Slocombe, a Washington tax attorney whose firm represents nonprofits, "the current 'substantially related' test would stand but Congress would impose tax on certain defined activities that are not taxable under current law."

Just which of the defined activities are likely to be made taxable is far from clear. Small business has obviously made inroads by arguing that nonprofits, particularly hospitals, museums, and universities, have crossed the line into unfair competition with taxpaying businesses. Hospital laundries, museum merchandising of art and artifacts, and university computer sales are frequently cited. Observers say that the current odds favor a tightening of UBIT rules.

Congressman Pickle, however, is said to have aimed at sending a finished set of proposals to the full committee before the political conventions. A vote was apparently held up because of differences within the committee, mainly along party lines, so that getting the bipartisan bill that the chairman wishes is expected to require significant modifications of the draft recommendations.

The emerging strategy of the nonprofits is to urge Congress to use caution in dismantling the carefully balanced UBIT structure built up over nearly four decades and to respond to complaints of unfair competition by making sure that abusers of the tax-exemption privilege are dealt with sternly.

Invoking the public benefits of their tax-exempt operations, the nonprofits have been lining up support, with the universities apparently the most active. Until the challenge to UBIT is put into concrete legislative form, however, the posture of many nonprofits will be what one staff member manning a scientific society's outpost in Washington called "nervous watching."

■ JOHN WALSH

## NSF and Antarctic Wastes

The Antarctica research stations run by the National Science Foundation (NSF) are polluting the pristine environment there with polychlorinated biphenyls (PCBs), raw sewage, used fuel, and emissions from burning waste, the Environmental Defense Fund asserts in a new report released this week.

Jack Talmadge, head of polar coordination and information at NSF, acknowledged that NSF activities have contributed pollution to the area, but argued that the agency "has made extensive efforts to clean up there." He noted that he had not yet seen the report. Talmadge said that a management plan to control pollution has been extensively discussed and is expected to be approved "shortly."

Bruce S. Manheim, the author of the report, "On Thin Ice," and an attorney at the environmental group, said that NSF has fallen short of complying with the letter and spirit of international agreements related to environmental protection of Antarctica and federal pollution regulations. While other countries have drawn up plans to manage pollution by their own research stations there, the United States still has not, he says.

Manheim concedes that at present it is unclear whether the pollution has significantly harmed fauna or flora in Antarctica, which includes penguins, seals, krill, lichens, and plankton. But this uncertainty, he says, stems from NSF's own failure to establish a monitoring and enforcement program to track the pollution created by research activities and analyze its potential impact.

The most compelling example of pollution by NSF activities, Manheim says, is the high concentrations of PCBs in McMurdo Bay, where the largest of several NSF research stations in Antarctica is located. As many as 1300 researchers and staff work there during the austral summer. Manheim says that an NSF-funded study by Raytheon Service Company showed that PCB concentrations in McMurdo Bay ranged from 18 to 340 parts per billion (ppb) as measured by conservative measurement techniques. By comparison, a recent National Oceanic and Atmospheric Administration study showed that Galveston Bay registered no PCB concentration and Oakland Bay averaged 70 ppb, he says. Talmadge asserts that Raytheon's PCB measurements might not be reliable.

Manheim reports that raw sewage is routinely dumped without treatment into the Antarctic environment at McMurdo Bay. The station has a dump even though landfills are barred by a voluntary international code, Manheim says. Solid waste is burned in a large open pit with no emission controls. In addition, there are no accounting procedures in place for monitoring the disposal of toxic wastes. Scrap metal and old vehicles are junked in the area rather than being hauled out by ship, he says. The report also criticizes NSF for not requiring scientists in their research proposals to provide an environmental impact evaluation of their activities, such as blasting with dynamite.

Talmadge concedes that raw sewage is released into the Bay, but contends that it does not need treatment. He said that some agency scientists are concerned that chlorinated waste would cause more ecological harm there. He said that the landfill does exist and that open burning has been allowed. These activities "have gone on in the past, but we're trying to correct it," he said. NSF "plans to cease" burning waste.

Talmadge said that it is "true" that scientists are not required to submit an environmental evaluation of their research proposals. But the primary responsibility for flagging potential ecological problems related to Antarctica rests with NSF program managers, he said.

Talmadge remarked that an NSF committee recently recommended that Congress make a one-time appropriation to fund the cleanup of McMurdo. (No specific amount was suggested.) "We're dealing with a 30-year accumulated problem," he commented.

Talmadge argues that while pollution has occurred, it should be kept in perspective in terms of the enormous size of the continent and the surrounding oceans. "It's a question of scale," he says.

Manheim says, "I don't agree with the 'dilution pollution' argument. NSF's behavior has excluded discussion with the public, which includes not only environmental groups, but EPA [the Environmental Protection Agency], and Congress."

■ MARJORIE SUN