Tax-Exempt Implications of Tax Cuts and Jobs Act



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The current bill for the Tax Cuts and Jobs Act, which was signed by President Trump on Friday, has several provisions impacting tax-exempt organizations. Below is a brief overview of the highlights of those provisions.

Highlights of the Provisions

- Require tax-exempt organizations to calculate unrelated business taxable income (UBTI) separately for each trade or business carried on — in effect prohibiting deductions relating to one business from offsetting income derived from another business. This provision is effective for tax years beginning after December 31, 2017. This could be a big deal for exempt organizations that have been using losses from one activity to offset income from another. Importantly, net operating losses from prior years will continue to be available to offset net income, regardless of the source of the loss.
- Require tax-exempt organizations to increase UBTI by the amount of certain fringe benefits, such as qualified transportation and on-premise athletic facilities, provided to their employees, effective for amounts paid or incurred after December 31, 2017.
- Repeal the exclusion from gross income for interest on a bond issued to advance refund another bond for bonds issued after December 31, 2017.
- Repeal the authority to issue tax credit bonds and direct-pay bonds issued after December 31, 2017.
- Private activity bonds, which were on the chopping block in the House version of the bill, remain intact, for now – there is continuing discussion in Congress on returning private activity bonds to the purposes for which they were originally intended.
- Impose a 1.4% excise tax on net investment income on private colleges and universities (and their related organizations) that: (1) have at least 500 students; (2) have at least 50% of their students located within the United States; and (2) have assets (other than assets used directly in carrying out the institution's educational purpose) with an aggregate fair market value of at least $500,000 per full-time student at the end of the preceding year. The assets and net investment income of related organizations would be included in determining the applicability and amount of the tax if the assets and income are available to the educational institution. The tax will be effective for tax years beginning after December 31, 2017. Harvard has estimated that, had this provision been in place last year, its tax bill would have been $43 million.
- Impose an excise tax of 21% on compensation, plus any parachute payment in excess of $1,000,000, paid to any of a tax-exempt organization's five highest compensated employees for the year and any employee who was one of the organization's five highest paid employees in any tax year beginning after 2016. The tax would apply to W-2 wages, not including designated Roth contributions, but including amounts included under 457(f). In addition, payments to medical professionals for providing medical or veterinary services would be exempted from the definition of "compensation" for purposes of the tax. The tax would be effective for tax years beginning after 2017. This provision applies to both public and private organizations and includes compensation from any related or governmental entity. So, paying a senior executive or coach $6mm will cost the organization an additional $1,050,000.

While the itemized deduction for charitable donations was not repealed, the Act does disallow certain other itemized deductions and increase the standard deduction for individuals, thus removing the benefit of a charitable deduction for many. A 2017 study by the Indiana University Lilly Family School of Philanthropy suggests that charitable giving may drop by up to $13 billion annually. For fundraisers, we're suggesting focusing more on the good you do and less on

deductibility, at least for smaller donors.

Also keep in mind that while the increased standard deduction and lowering of itemized deductions is expected to result in only 5% of taxpayers itemizing deductions, before the change only about 30% itemized — so even before this change, 70% of taxpayers got no benefit from charitable contributions and yet, many contributed anyway.

Disclaimer

The information presented is not intended to be a full and exhaustive explanation of the tax bills referenced. Please consult your tax advisor regarding the policies that might be applicable to your specific situation.