

INSIGHTS

After the Dust Settles: Recapping Certain Tax Reform Provisions Affecting Exempt Organizations

May 31, 2018

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As is well known, on December 22, 2017, President Trump signed the Tax Cuts and Jobs Act (the “Final Bill”) into law. During the course of this massive legislative effort, various provisions affecting tax-exempt organizations were proposed. While receiving less attention than more prominent aspects of the Final Bill, many of these provisions were eventually enacted. Highlighted below are some of the provisions of the Final Bill that affect exempt organizations.

Provisions that Could Affect Charitable Giving

The most prominent feature of the Final Bill, and the one that garnered most of the national attention, is the reduction of the tax rates, with the corporate tax rate reduced from a maximum rate of 35% to a flat rate of 21%, and the top individual rate reduced from 39.6% to 37% (the reduced individual reduction expires at the end of 2025). While the lower tax rates could cause taxpayers to have additional resources available for philanthropic purposes, they may reduce the tax value of making charitable contributions.

The Final Bill also includes certain provisions relating to deductions that could be a disincentive for charitable giving. For example, the Final Bill nearly doubles the standard exemption amount, which could cause fewer taxpayers to itemize their deductions (which include charitable contributions). Further, the Final Bill eliminates the charitable deduction for payments in connection with the right to purchase seating at athletic events at certain colleges and universities.

However, other provisions of the Final Bill could actually incentivize charitable giving. For taxpayers who continue to itemize deductions, the Final Bill increases the limit on cash contributions to public charities from 50% to 60% of adjusted gross income. The Final Bill also reduces the mortgage interest deduction from \$1 million to \$750,000 for married filers and caps the deduction of state and local taxes at \$10,000, meaning that some taxpayers may consider making additional charitable contributions to otherwise offset the new capped amounts.

Computation of Unrelated Business Taxable Income

Before the enactment of the Final Bill, an exempt organization that carried on multiple unrelated trades or businesses was permitted to calculate any resulting unrelated business taxable income liability on an aggregate basis – meaning that the organization could use a deduction from one business to offset income earned from another business. The Final Bill eliminates this ability by forcing an exempt organization to separately calculate its tax liability

(i.e., income from a business may only be offset by deductions from that business). While questions remain as to which activities constitute separate trades or businesses, this provision of the Final Bill could result in increased tax liability for some exempt organizations (although the reduced corporate tax rate of 21% discussed above may help to ease the burden of additional taxable income resulting from this new calculation method).

In addition, the Final Bill requires exempt organizations to include in unrelated business taxable income the amount of certain fringe benefits (i.e., qualified transportation fringes) for which a deduction is disallowed.

Excise Tax on Executive Compensation

The Final Bill imposes an excise tax equal to the corporate tax rate (i.e., 21%) on so much of the remuneration paid by certain tax-exempt organizations to any covered employee in excess of \$1 million in a tax year, plus certain excess parachute payments. A “covered employee” is any employee (including any former employee) of an applicable tax-exempt organization if the employee is one of the five highest compensated employees of the organization for the taxable year, or was a covered employee of the organization (or any predecessor) for any preceding taxable year beginning after December 31, 2016.

“Remuneration” means wages (as defined in section 3401(a) of the Internal Revenue Code of 1986, as amended), and is treated as paid when there is no substantial risk of forfeiture of the rights to such remuneration. In addition, an organization’s remuneration of a covered employee also includes remuneration paid with respect to the employment of that employee by certain related persons and governmental entities.

Notably, remuneration does not include any designated Roth contribution or the portion of any remuneration paid to a licensed medical professional (including a veterinarian) that is for the performance of medical or veterinary services by such professional. As a result of the exclusion of payments received in connection with providing medical or veterinary care, an exempt organization must make a reasonable allocation for covered employees who provide both medical and other services.

Excise Tax on Investment Income of Certain Private Colleges and Universities

The Final Bill imposes an excise tax equal to 1.4% on the net investment income of private colleges and universities that have (i) at least 500 tuition-paying students (more than 50% of which are located in the United States) and (ii) assets (including assets held by certain supporting or controlled organizations) that at the end of the preceding taxable year have a value of at least \$500,000 per student (excluding assets that are used directly in carrying out the institution’s exempt purpose). This provision has met significant objection from affected institutions and efforts to effectuate its repeal are ongoing (although it is impossible to say whether these efforts will gain any momentum).

Advance Refundings Eliminated

The Final Bill eliminates the ability of section 501(c)(3) organizations to advance refund outstanding tax-exempt bonds (i.e., bonds issued more than 90 days before the redemption of the refunded bonds) on a tax-exempt basis. The elimination of advance refundings significantly limits the flexibility of borrowers to lock-in debt service savings, restructure debt service, or to achieve relief from unfavorable financing terms. While alternative synthetic financing arrangements to mimic the economics of an advance refundings are likely to be developed,

these alternative arrangements likely will not be as efficient for issuers as advance refunding would have been.

Private Activity Bonds Live On (At Least for Now)

After being threatened in various stages of the legislative process, the Final Bill retains all categories of tax-exempt private activity bonds (“PABs”), including bonds issued for projects owned by section 501(c)(3) organizations (i.e., qualified 501(c)(3) bonds). Despite the favorable result for PABs in the Final Bill, now is not the time to rest easy. Some members of Congress continue to question whether the scope of projects financeable by PABs should be reduced to include only projects that are related to “national infrastructure,” the intended scope of which is unclear. Thus, those interested in the continued existence of qualified 501(c)(3) bonds should continue to extol their benefits to decision-makers in Washington.

Closing Remarks

All in all, it is too early to tell with any precision how the collective provisions of the Final Bill will affect exempt organizations. To be sure, the lower tax rates and increased standard deduction amount could affect the size and frequency of charitable contributions made by taxpayers. Nevertheless, those who are charitably inclined are likely to continue to support philanthropic causes irrespective of the Final Bill’s effect, and may in fact have additional resources available after taxes are paid. In addition, certain exempt organizations will have to develop new procedures and strategies for addressing provisions in the Final Bill that otherwise could be disruptive in fulfilling their exempt purpose.

For more information regarding the Final Bill and its effect on exempt organizations, please contact [Todd Greenwalt](#) or [Brian Teaff](#).