

February 7, 2018

U.S. Tax Reform

Tax-Exempt Organizations

The Tax Cuts and Jobs Act of 2017 (the “Act”) includes several tax provisions that will affect tax-exempt organizations and their donors. Each change is effective for tax years beginning after December 31, 2017 and has no sunset provision, except where noted otherwise.

- **Excise taxation of certain executive compensation.** Tax-exempt organizations are subject to a new excise tax on remuneration in excess of \$1 million paid to “covered employees,” defined as employees who were among the organization’s five most highly compensated in that year or any prior year (beginning in 2017). The excise tax is imposed at the prevailing corporate income tax rate, currently 21 percent. Certain severance payments to covered employees also are subject to the tax, and payments from multiple related organizations to the same individual are aggregated.
- **Excise taxation of certain college and university endowment income.** The Act imposes a new excise tax of 1.4 percent on the net investment income of certain private colleges and universities (but not state colleges or universities). A private school is subject to the tax in any year if it enrolled at least 500 students in the prior taxable year, more than 50 percent of whom were located in the United States, and the value of its endowment exceeded \$500,000 per student. The endowments of related tax-exempt organizations are aggregated for purposes of the tax.
- **Changes to Unrelated Business Income Taxation.** The Act makes two changes to the tax on unrelated business taxable income (UBTI), *i.e.*, income derived by a tax-exempt organization from a trade or business that is not substantially related to the performance of the organization’s tax-exempt purposes.
 - Tax-exempt organizations carrying on more than one unrelated trade or business are now required to compute UBTI separately for each such unrelated trade or business. Thus, exempt organizations are no longer permitted to apply losses or other deductions from one unrelated trade or business to offset income from another. Net operating losses from a particular trade or business may be carried forward to offset income in future tax years, but may only be applied to subsequent income from the same trade or business. Net operating losses from tax years beginning before January 1, 2018 still may be carried forward under the old rules and applied to the organization’s cumulative UBTI.

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- The definition of UBTI is expanded to include amounts paid or incurred by an organization in providing certain fringe benefits related to employee transportation, on-site employee parking, and employee gyms and athletic facilities.
- **Reforms to the charitable contributions deduction.** The Act modifies the deduction for contributions to tax-exempt charitable organizations in several respects.
 - For tax years beginning after December 31, 2017 and before January 1, 2026, the maximum allowable deduction for an individual's contributions of cash to public charities and certain other charitable organizations is increased from 50 percent of the contributor's adjusted gross income (AGI) to 60 percent. Contributions in excess of 60 percent of AGI may be carried forward for up to five years.
 - Payments made to institutions of higher education in exchange for the right to purchase tickets for athletic events are no longer deductible as charitable contributions.
 - The Act eliminates an exception to the requirement that contributions of \$250 or more be substantiated by contemporaneous written acknowledgment from the recipient charitable organization. Under the exception, a donor could rely on information substantiating the contribution included on a recipient organization's annual return, in lieu of receiving acknowledgment directly from the organization. For contributions made in taxable years beginning after December 31, 2016, donors may deduct only contributions for which the recipient charitable organization provides written substantiation directly to the donor.
 - The Act provides that the charitable contribution deduction of an "electing small business trust" (ESBT) is not determined by the rules generally applicable to trusts, but rather by the rules applicable to individuals. Thus, the percentage limitations and carryforward provisions applicable to individuals apply to charitable contributions made by the portion of an ESBT holding S corporation stock.

Questions regarding the effects of the Act's provisions on tax-exempt organizations may be directed to any member of the Estates & Personal Group. Contact information is available on the final page of this memorandum.

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