

# Tax Reform Advisory: Exempt Organizations

December 29, 2017

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On December 22, 2017, the President signed into law H.R. 1, informally known as the **"Tax Cuts and Jobs Act" (the "Act")**, implementing sweeping changes to United States tax regimes for exempt organizations, businesses in which they invest and individuals donating to such organizations. Most provisions of the **Act will take effect as of January 1, 2018**, and will apply to exempt organizations for tax years beginning after 2017. Highlights of the Act impacting exempt organizations are discussed below.

## **Unrelated Business Taxable Income**

The Act increases unrelated business taxable income ("UBTI") by requiring that exempt organizations calculate UBTI separately for each unrelated business activity and deductions from one business activity may no longer be used to offset income from another business activity. For example, current losses or NOL carryovers from an unrelated consulting business may no longer be used to offset income or gains from an unrelated parking operation. This rule is effective for amounts paid or incurred or taxable years beginning after 2017. The Act also limits the use of net operating loss (NOL) deductions incurred in the same business in prior years to 80% of the taxable income from such activity or business. While the Act generally eliminates NOL carrybacks (except for farming businesses), NOLs generated after December 31, 2017 may be carried forward indefinitely. The Act also disallows certain fringe benefit expenses in the calculation of UBTI.

Although these changes would generally increase the amount of tax on UBTI for an organization with any unrelated business activity, the Act's tax breaks for business entities (e.g., the reduction of the corporate tax rate from 35% to 21%, the repeal of the corporate alternative minimum tax, and the 20% deduction for pass-through entities held by charitable trusts or other non-corporate tax-exempt organizations, subject to important limitations) will provide a corresponding impact to UBTI and the tax due on it.

Please refer to our [Corporate and Business Provisions Advisory](#) for a more detailed discussion of the tax changes for business entities.

## **Excise Tax on Executive Compensation**

The Act imposes an excise tax equal to the corporate tax rate under the Act (21%) on compensation in excess of \$1 million and certain parachute payments (generally payments that are contingent upon separation of employment that exceed a certain base amount) paid to a "covered employee" by an applicable organization or by related parties to the applicable organization. A covered employee includes the five highest-paid employees (or former employees) of an applicable organization for the relevant tax year (or anyone who had been one of the five highest-paid

employees in a prior tax year beginning after 2016). As a result, the excise tax will generally apply to compensation in excess of \$1 million paid to anyone who has ever been one of the five highest-paid employees in a tax year beginning after 2016.

Additionally, deferred and other compensation is included in the calculation of the excise tax when it is no longer subject to a "substantial risk of forfeiture." This means the excise tax applies to deferred compensation upon vesting rather than upon actual receipt.

Special rules applying to licensed medical professionals and qualified medical professionals exempt from the excise tax compensation paid to those professionals for the performance of medical or veterinary services.

## **Excise Tax on Investment Income of Certain Private Colleges and Universities**

For tax years beginning after 2017, the Act imposes a 1.4% excise tax on private colleges and universities with more than 500 students and assets of at least \$500,000 per full-time student. For purposes of calculating the tax, assets used directly for educational purposes are excluded, but assets and net investment income of related organizations will be aggregated and included if they are available for the use or benefit of the educational institution. The terms "used directly" and "available for use," along with the computation of net investment income will all be described more fully in to-be-promulgated regulations. The number of full-time students is based on the daily average of full-time (or full-time equivalent) students, and the tax only applies if a majority of the students are located in the U.S.

## **Charitable Contributions**

Also of interest to exempt organizations, the Act has made the following changes to the charitable donations rules:

- The adjusted gross income (AGI) limitation on cash contributions to public charities has been increased from 50% to 60%.
- The 80% deduction for contributions for university athletic seating rights has been repealed.
- The exception from the contemporaneous written acknowledgment requirement for contributions of \$250 or more when the charitable donee makes the appropriate filing is (retroactively) repealed for contributions made after December 31, 2016.

## **What's NOT covered by the Act**

For clarity, the following provisions originally in the House bill did not make it into the Act:

- A flat excise tax of 1.4% on investment income of private foundations.
- Additional restrictions on organizations operating art museums in order to qualify as operating foundations.
- An exception to the excess business holdings excise tax that would have exempted certain private foundations from the 10% tax for holding a 20% interest in a for-profit business and

the corresponding 200% excise tax for those private foundations that did not divest their holdings within a prescribed time period.

- A provision allowing 501(c)(3) organizations to make political statements in the ordinary course of carrying out their exempt purposes.
- A requirement for exempt organizations sponsoring donor advised funds (or “DAFs”) to disclose information about the average amounts of grants made and the policies in place for making distributions from inactive DAFs.

To read our other advisories regarding the Act, please follow the below links:

- [Corporate and General Business](#)
- [International Provisions](#)
- [Private Client & Trust](#)
- [Real Estate](#)

If you have a tax question or business concern, we invite you to reach out directly to any member of our **Private Client & Trusts** or **Tax** Groups.

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