

The US House of Representatives and the US Senate have each passed tax legislation that could have a major impact on tax-exempt organizations. The bills appear to be headed to a conference committee to resolve the differences between the bills. This alert highlights provisions of the two bills that may affect tax-exempt organizations.

Charitable Giving

Both bills retain the deductions for charitable contributions but make other changes that could reduce charitable giving. With respect to individuals, both bills almost double the standard deduction and eliminate certain itemized deductions, thereby increasing the number of taxpayers who will claim the standard deduction and, therefore, do not have a tax benefit for charitable contributions. The House bill may have a bigger impact than the Senate bill because it eliminates almost all itemized deductions other than the charitable deduction, a limited mortgage interest deduction and a property tax deduction of up to \$10,000 – meaning, fewer individuals are likely to itemize, which will generally suppress the tax benefit of charitable donations. The Senate bill retains more itemized deductions, which could make it somewhat more likely that a greater number of individuals will continue to itemize.

Both bills also reduce the corporate income tax rate to 20%, but the Senate bill defers the reduced rate until 2019. This lower rate could reduce the incentive for corporate charitable giving. Both bills almost double the levels at which federal estate taxes begin to apply; the House bill repeals the estate tax effective January 1, 2025. Thus, both bills will reduce the number of estates that will claim the charitable deduction.

On the positive side for tax incentives for individual charitable giving, both bills:

- Retain relatively high tax rates for taxpayers in the highest tax brackets
- Repeal the Pease adjustments, which phase down itemized deductions as income increases
- Increase the individual limitation for cash contributions to public charities and certain foundations to 60% of the taxpayer's adjusted gross income

Both bills repeal the special rule enabling a donor to take charitable deduction of 80% of the amount paid for the right to purchase tickets to athletic events.

The House bill increases the charitable mileage rate for inflation.

Tax-Favored Financing

The House bill repeals the exemption for interest paid on private activity bonds, including section 501(c)(3) bonds and qualified student loan bonds, for bonds issued after 2017. Both bills repeal the exemption for interest paid on advance refunding bonds issued after 2017.

The House bill repeals credits that certain tax-exempt organizations use directly or indirectly to help finance tax-exempt purposes, including the rehabilitation (historic) tax credit and the new markets tax credit. The Senate bill would neither repeal nor extend the new markets tax credit. It limits the rehabilitation credit to certified historic structures and requires that it be taken ratably over five years.

All these provisions would decrease the tax-favored financing alternatives available to tax-exempt entities.

Governance and Compensation

Both bills impose a 20% excise tax on a tax-exempt employer with respect to remuneration in excess of \$1 million paid to a covered employee. For these purposes, remuneration means wages as defined for income tax withholding purposes, but does not include designated Roth contributions. The bills would also apply "excess parachute payment" rules to severance payments made to covered employees. Covered employees include current and former employees who were one of the five highest paid employees of the organization or predecessor of any preceding taxable year beginning after 2016. Compensation paid by related entities is aggregated and the tax apportioned in the case of a covered employee working for multiple organizations.

The Senate bill does not include changes in the excess benefit transaction rules that were included in the version of the bill that the Senate Finance Committee approved.

Political Activity

The House bill provides a waiver to the "Johnson Amendment" by permitting section 501(c)(3) organizations to make political statements "in the ordinary course of the organization's regular and customary activities" if the organization does not incur more than a *de minimis* incremental expense. For example, if the modification is adopted, a pastor could endorse or criticize a candidate during a sermon without jeopardizing the tax-exempt status of the church. Similarly, an organization could identify on its website opposition to candidates who propose defunding the organization. The waiver expires for tax years beginning after 2023. The loosening of the Johnson Amendment is controversial; the Senate bill has no similar provision.

Unrelated Business Taxable Income

The Senate bill requires that an organization with more than one unrelated trade or business compute unrelated business taxable income (UBTI) separately with respect to each trade or business. Thus, the losses from one trade or business could not offset income from another trade or business. The organization's UBTI for a year would be the sum of the positive amounts of UBTI for each trade or business with positive UBTI, less the specific deduction allowed in computing UBTI subject to tax. The House bill does not include a similar provision. The Senate bill does not include a provision that the Finance Committee approved, which would treat royalty income as UBTI.

The House bill limits the UBTI exception for fundamental research organizations to income arising from research the results of which are freely available to the public. The House bill subjects certain state and local entities, such as public pension plans, that are exempt under section 115 to the unrelated business income tax. This could have a major impact on pension plans that invested, without use of corporate blockers, in partnerships that generate active business income. The Senate bill does not include similar provisions. The House bill, but not the Senate bill, includes in UBTI the amount of certain fringe benefits for which the House bill denies businesses a deduction in the "for profit" world. These include qualified transportation fringe benefits, costs of on-premises athletic facilities and costs of parking facilities used in connection with qualified parking.

Private Foundations and Donor Advised Funds

The House bill, but not the Senate bill, changes tax rules relating to private foundations and donor advised funds by:

- Simplifying the excise tax on private foundation net investment income by adopting a single rate of 1.4%
- Denying private operating foundation status to art museums not open to the public during normal business hours for at least 1,000 hours per year
- Requiring sponsoring organizations of donor advised funds to disclose policies on inactive donor advised funds and average amounts of grants made from their donor advised funds

The House bill also includes a tightly tailored provision exempting certain business holdings from the tax on excess building holdings applicable to private foundations. The provision reportedly benefits the Newman's Own Foundation.

Colleges and Universities and Educational Benefits

Both bills impose a new 1.4% excise tax on the net investment income of private colleges and universities that have at least 500 students and assets, other than those used directly in carrying out the institution's educational purposes. The House bill applies to endowments of at least \$250,000 per full-time student; the Senate bill sets the threshold at \$500,000 per student. The Senate bill, but not the House bill, exempts colleges and universities that do not receive funds under Title IV of the Higher Education Act and state colleges and universities. The excise tax takes into account the net investment income of related organizations, such as supporting and supported organizations.

The House bill, but not the Senate bill, repeals certain tax benefits associated with saving for, payment of or borrowing to pay tuition, including (i) above-the-line deductions for interest payments on qualified education loans and qualified tuition and related expenses and (ii) income exclusions for:

- Interest on US savings bonds used for qualified higher education expenses
- Qualified tuition reductions provided by educational institutions
- Employer provided educational assistance

The Senate bill, but not the House bill, allows funds from section 529 accounts to be used for elementary and high school education. The House bill, but not the Senate bill, integrates Coverdell savings accounts with section 529 plan accounts by expanding the uses of section 529 plan accounts and eliminating new Coverdell accounts. The House bill also integrates tax credits for education.

What's Next?

We expect that either the House and Senate will send the bills to a conference committee to resolve the differences or leadership of the House and Senate will seek to develop a new bill that resolves differences. While final legislation should include provisions that were included in both bills, sometimes, common provisions are dropped as a final bill is developed.

While there is significant momentum toward passage of a final bill before Christmas, changes in the bills could erode the small majority by which each chamber passed its bill. That could stall efforts to resolve differences or result in a bill that one chamber cannot pass.

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