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# Impact of the “Tax Cuts and Jobs Act” on Tax-Exempt Organizations

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## ... What Are We Covering Today?

1. Key Provisions in the Tax Cut and Jobs Act directly impacting Exempt Organizations.
2. Changes with Unrelated Business Income (UBI).
3. Updates to the Form 990.
4. Areas of the Tax Cuts and Jobs Act indirectly impacting Exempt Organizations.

## Key Provisions in the Tax Cuts and Jobs Act Impacting Exempt Organizations

1. Repeal of advance refunding bonds.
2. Credit bonds repealed.
3. Excise tax on excess tax-exempt organization executive compensation.
4. Excise tax based on investment income of private colleges and universities.
5. Multiple changes with Unrelated Business Income (UBI).

## ... Repeal of Advance Refunding Bonds

Pre-Act Law: The exclusion for income for interest on State and local bonds applies to refunding bonds, but there are limits on advance refunding bonds. A refunding bond is defined as any bond used to pay principal, interest, or redemption price on a prior bond issue (the refunded bond).

1. A current refunding occurs when the refunded bond is redeemed within 90 days of issuance of the refunding bonds.
2. Conversely, a bond is classified as an advance refunding if it is issued more than 90 days before the redemption of the refunded bond. Proceeds of advance refunding bonds are generally invested in an escrow account and held until a future date when the refunded bond may be redeemed.



## ... Repeal of Advance Refunding Bonds

New Law: For advance refunding bonds issued after December 31, 2017, the exclusion from gross income for interest on a bond issued to advance refund another bond is repealed.

## ... Credit Bonds Repealed

Pre-Act Law: Tax-credit bonds provide tax credits to investors to replace a prescribed portion of the interest cost. The borrowing subsidy generally is measured by reference to the credit rate set by the Treasury Department. Current tax-credit bonds include qualified tax credit bonds, which have certain common general requirements, and include new clean renewable energy bonds, qualified energy conservation bonds, qualified zone academy bonds, and qualified school construction bonds.

## ... Credit Bonds Repealed

New Law: For bonds issued after December 31, 2017, the authority to issue tax-credit bonds and direct-pay bonds is prospectively repealed.



## ... Excise Tax on Excess Tax-Exempt Organization Executive Compensation

Pre-Act Law: There were reasonableness requirements and a prohibition against private inurement with respect to executive compensation for tax-exempt entities, but no excise tax tied to the amount of compensation paid.

## ... Excise Tax on Excess Tax-Exempt Organization Executive Compensation

New Law: For tax years beginning after December 31, 2017, a tax-exempt organization is subject to an excise tax at the corporate tax rate (currently 21 percent) on the sum of:

1. The remuneration (other than an excess parachute payment) in excess of \$1 million paid to a covered employee by the applicable tax-exempt organization to a covered employee; and
2. Any excess parachute payment paid by the applicable tax-exempt organization to a covered employee.

\*Form 990, Part V, Line 15 Question.

## ... Excise Tax on Excess Tax-Exempt Organization Executive Compensation

Covered employee - is an 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 tax year or was a covered employee of the organization (or a predecessor) for any preceding tax year beginning after December 31, 2016.

## ... Excise Tax on Excess Tax-Exempt Organization Executive Compensation

- For purposes of determining Excess remuneration – wages include all remuneration for services performed by an employee for the employer, except for fees paid a public official, and other specifically excluded types of remuneration
- Remuneration is treated as paid when there is no substantial risk of forfeiture of the rights to such remuneration.

## ... Excise Tax on Excess Tax-Exempt Organization Executive Compensation

Compensation includes remuneration from “related entities.”

- Related if controls or is controlled by.
- Supporting or supported organization.
- “Brother/sister” relationship.



## ... Excise Tax on Excess Tax-Exempt Organization Executive Compensation

Excess parachute payment – is an amount equal to the excess of any parachute payment over the portion of the base amount. A parachute payment is any payment in the nature of compensation to (or for the benefit of) a covered employee if:

- Such payment is contingent on such employee's separation from employment with the employer; and
- The aggregate present value of the payments in the nature of compensation to (or for the benefit of ) such individual which are contingent on such separation equals or exceeds an amount equal to three times the base amount.

## ... Excise Tax Based on Investment Income of Private Colleges and Universities

Pre-Act Law: Private colleges and universities generally are treated as public charities rather than private foundations and thus are not subject to the private foundation excise tax on net investment income.

## ... Excise Tax Based on Investment Income of Private Colleges and Universities

New Law: For tax years beginning after December 31, 2017, an excise tax equal to 1.4 percent is imposed on net investment income of certain private colleges and universities.

\* Form 990, Part V, Line 16 Question.

## ... Excise Tax Based on Investment Income of Private Colleges and Universities

- The tax applies only to private colleges and universities with at least 500 students, more than 50 percent of the students of which are located in the U.S., and with assets (other than those used directly in carrying out the institution's exempt purpose) of at least \$500,000 per student.

## ... Excise Tax Based on Investment Income of Private Colleges and Universities

- The number of students is based on the daily average number of full-time equivalent students (full-time students and part-time students on an equivalent basis).
- “\$500,000 per student” is calculated on aggregate fair market value of assets at end of preceding taxable year, excluding assets used directly in carrying out exempt purpose.
- Net investment income is gross investment income minus expenses to produce the investment (but disallowing the use of accelerated depreciation methods or percentage depletion).





## Unrelated Business Income Tax Rates

Pre-Act Law: All organizations subject to UBIT, were subject to graduated rates on that income. For example, corporate tax rates were, as follows:

- 15 Percent of the UBTI less than \$50,000;
- 25 Percent of the UBTI between \$50,000 and \$75,000;
- 34 Percent of the UBTI between \$75,000 and \$10 million; and
- 35 Percent of the UBTI over \$10 million.



## Unrelated Business Income Tax Rates

New Law: Flat tax rate of 21 percent.

That means that UBTI over \$90,385 per each trade or business is paying a lower tax bill than they would have before.

## ... Unrelated Business Income Tax Net Operating Loss (NOL)

Pre-Act Law: NOLs could be carried forward 20 years to offset taxable income in such years. NOLs could be carried back 2 years to offset income recognized in the past, sometimes generating a refund of previously paid taxes. NOLs could be used to offset a full 100 percent of a corporation's taxable income

## ... Unrelated Business Income Tax Net Operating Loss (NOL)

### New Law:

- Post December 31, 2017, NOL deductions are limited to 80 percent of taxable income.
- Eliminates carrybacks of NOLs.
- Unused NOLs are carried forward indefinitely.

## ... UBTI Separately Computed for Each Trade or Business Activity

Pre-Act Law: A tax-exempt organization determines its unrelated business taxable income (UBTI) by subtracting, from its gross unrelated business income, deductions directly connected with the unrelated trade, or business. Under regulations, in determining UBTI, an organization that operates multiple unrelated trades or businesses aggregates income from all such activities and subtracts from the aggregate gross income the aggregate of deductions. As a result, an organization may use a deduction from one unrelated trade or business to offset income from another, thereby reducing total unrelated business taxable income.



## ... UBTI Separately Computed for Each Trade or Business Activity

New Law: For tax years beginning after December 31, 2017 (subject to an exception for net operating losses (NOLs) arising in a tax year beginning before January 1, 2018, that are carried forward), losses from one unrelated trade or business may not be used to offset income derived from another unrelated trade or business. Gains and losses have to be calculated and applied separately.

## ... Unrelated Business Income (UBI)

Activity is unrelated business income if it meets three requirements:

1. It is a trade or business.
2. It is regularly carried on.
3. It is NOT substantially related to furthering the exempt purpose of the organization.

## ... Unrelated Business Income (UBI)

- Activity can potentially jeopardize an organization's tax-exempt status when there is too much income generated from activities that are unrelated to the exempt function of the organization.
- Also devoting a disproportionate amount of time to such endeavors could jeopardize the organization's status.
- No hard-fast rules in this area and the Internal Revenue Service evaluates unrelated income issues on a case-by-case basis.

## ... Unrelated Business Income (UBI)

Some of the most common UBI generating activities include:

- The sale of advertising space in weekly bulletins, magazines, journals, or on the organization's website;
- The sale of merchandise and publications when those items being sold do not have a substantial relationship to the exempt purpose of the organization;
- Provision of management or other similar services to other organizations; and
- Even some types of fundraising activities.

## ... UBTI Separately Computed for Each Trade or Business Activity

How do you determine what are considered separate business activities?

- For example, similar activities conducted in-person and online. Is “facility rental” one “trade or business” or is it determined by the type of facility?
- Use of the North American Industry Classification System (NAICS) 6-digit codes will be considered a reasonable, good-faith interpretation.



## ... UBTI Separately Computed for Each Trade or Business Activity

An exempt organization may aggregate its UBTI from its interest in a single partnership with multiple trades or businesses if the de minimis or control test is met.

- De minimis test – is satisfied if the exempt organization holds directly no more than 2 percent of the profits interest and no more than 2 percent of the capital interest of the partnership.
- Control test – is satisfied if the exempt organization holds no more than 20 percent of the capital interest and does not have control or influence over the partnership.

## ... New UBIT Tax on Non-Profit Qualified Transportation Fringes (QTF), Parking, and On-Premises Athletic Facilities

Pre-Act Law: Tax-exempt organizations could provide employees with certain fringe benefits free from tax at the employer level.

## ... New UBIT Tax on Non-Profit Qualified Transportation Fringes (QTF), Parking, and On-Premises Athletic Facilities

New Law: Unrelated business tax income increased by amount for which a deduction is disallowed under Internal Revenue Code Section 274 and which is “paid or incurred” by the organization for certain fringe benefits.

- Qualified transportation fringe benefits.
- Parking facility used in connection with qualified parking.
- On-premises athletic facilities.

## ... New UBIT Tax on Non-Profit Qualified Transportation Fringes (QTF), Parking, and On-Premises Athletic Facilities

- Internal Revenue Service has issued preliminary guidance on this provision. Taxpayers are permitted to rely on this notice until final guidance/regulations are issued.
- Non-profits that make certain fringe benefits available to their employees are required to pay tax on these benefits as if they were unrelated business income.
- First time that UBIT applies not to only income, but to expenses.
- Why? Taxable organizations can no longer deduct these benefits.

## ... New UBIT Tax on Non-Profit Qualified Transportation Fringes (QTF), Parking, and On-Premises Athletic Facilities

### Solutions:

- To avoid the UBIT liability, an employer organization can either provide the benefits as taxable items to the employees or discontinue providing the benefits.
- Tax-exempt organizations may wish to consider replacing these benefits with higher compensation or other benefits of equivalent value to their employees, but which do not trigger UBIT.



## ... On-Premises Athletic Facilities

A deduction for expenses paid or incurred for on-premises athletic facilities is disallowed only if it discriminates in favor of highly compensated employees.

## ... UBIT Tax on Non-Profit Qualified Transportation Fringes (QTF)

Qualified Transportation Fringes include:

- Transportation in a commuter highway vehicle between the employee's residence and place of employment;
- Any transit pass; and
- Qualified parking.

## ... UBIT Tax on Non-Profit Qualified Transportation Fringes (QTF)

- The amount of QTFs provided by an employer to any employee that can be excluded from the employee's gross income cannot exceed a maximum monthly dollar amount, adjusted for inflation (\$260 in 2018).
- An employer may provide QTFs as a supplement to an employee's compensation, either in kind or through a bona fide cash reimbursement arrangement or even via compensation reduction agreements.
- Section 274(a)(4) disallows a deduction for expenses incurred for QTFs regardless of how the benefit is provided to the employee.

## ... Fringe Benefits: Parking Expense

Example: Taxpayer leases parking spots from a third party for employees.

Result: UBIT is imposed on the amount paid for the parking.

*Note: Expense is subject to monthly limitation on exclusion, any excess is treated as compensation and wages to the employee.*

## ... Fringe Benefits: Parking Expense

Example: Organization owns or leases all or part of the parking facility.

Result: Until further guidance is issued, the cost of parking (not value) must be computed using any reasonable method. Total parking expense includes all the costs of maintaining, such as repairs, maintenance, insurance, taxes, snow removal, parking attendant, etc. Depreciation does not need to be included.



## ... Categories of Parking: Step 1

Employee Reserved Spots – if spaces reserved for employees are released from this designation and made available to the public before March 31, 2019, they are deemed, retroactively to January 1, 2018, not to be employee-reserved spots.

Change parking arrangements by changing signage, access, etc.

## ... Categories of Parking: Step 2

Primary Use Test – if more than 50 percent of the use of a parking spot is by the general public, then it is deemed not to be subject to the tax at all (not just to the extent of public use).

“General public” – includes, but is not limited to, customers, clients, visitors, individuals delivering goods, or services to the taxpayer, patients of a health care facility, students of an educational institution, and congregants of a religious organization.

## ... Categories of Parking: Step 2

Primary Use Test – Primary use of the parking spots is tested during normal business hours on a typical business day, or in the case of an exempt organization during the normal hours of the exempt organization's activities on a typical day.

## ... Categories of Parking: Step 3

Reserved Non-Employee Spots – if the primary use of the taxpayer's remaining parking spots is not by the general public, the taxpayer may identify the number of spots exclusively for non-employees.

Reserved nonemployee spots include spots reserved for visitors and customers, as well as spots reserved for partners, sole proprietors, and 2 percent shareholders of S Corporations.

## ... Categories of Parking: Step 4

Remaining Spots – if there are remaining spots after the above, then the organization must reasonably determine employee use during the normal hours of the exempt organization's activities on a typical day.



## ... Form 990-T: Exempt Organization Business Income Tax Return

- The IRS has released a draft form with instructions reflecting the new tax.
- Organizations with under \$1,000 in UBIT from parking are not required to file this form.
- A separate IRS notice released (2018-100) provides relief to certain taxpayers who have not previously filed Form 990-T with respect to the estimated tax penalties arising from the treatment of qualified transportation fringes.

## ... New York State Response

Bill signed on December 7, 2018, exempting parking-related UBIT from New York franchise tax.

## ... Example 1 for Determining Parking

Tax-exempt organization J, a religious organization that operates a church and a school, owns a surface parking lot adjacent to its buildings. J incurs \$10,000 of total parking expenses.

J's parking lot has 500 spots that are used by its congregants, students, visitors, and employees, and 10 spots that are reserved for certain employees. During the normal hours of J's activities on weekdays, J usually has approximately 50 employees parking in the lot in non-reserved spots and approximately 440 non-reserved parking spots that are empty. During the normal hours of J's activities on weekends, J usually has approximately 400 congregants parking in the lot in non-reserved spots and 20 employees parking in the lot in non-reserved spots.

## ... Example 1 for Determining Parking

Step 1: Because J has 10 reserved spots for certain employees, \$200  $((10/500) \times \$10,000 = \$200)$  is the amount of total parking expenses that is nondeductible for reserved employee spots under § 274(a)(4). Thus, under § 512(a)(7), J must increase tax its UBTI by \$200, the amount of the deduction disallowed under § 274(a)(4).

## ... Example 1 for Determining Parking

Step 2: Because usage of the parking spots varies significantly between days of the week, J uses a reasonable method to determine that the primary use of the remainder of J's parking lot is to provide parking to the general public because 90 percent ( $440/490 = 90$  percent) of the spots are used by the public during the weekdays and 95 percent ( $470/490$ ) of the spots are used by the public on the weekends. The empty, nonreserved parking spots are treated as provided to the general public. Thus, expenses allocable to these spots are excepted from the § 274(a) disallowance by § 274(e)(7) under the primary use test, and only \$200 of the \$10,000 is subject to the § 274(a)(4) disallowance. Therefore, only \$200 of the expenses for the provision of the QTF will result in an increase to UBTI under § 512(a)(7).



## ... Example 1 for Determining Parking

Solution: If J does not have gross income from any unrelated trades or businesses of \$800 or more included in computing its UBTI (to reach the \$1,000 filing threshold), J is not required to file a Form 990-T for that year.

## ... Example 2 for Determining Parking

Tax-exempt organization K is a hospital and owns a surface parking lot adjacent to its building. K incurs \$10,000 of total parking expenses.

K's parking lot has 500 spots that are used by its patients, visitors, and employees. K has 50 spots reserved for management and has approximately 100 employees parking in the lot in non-reserved spots during the normal operating hours of the hospital.

## ... Example 2 for Determining Parking

Step 1: Because K has 50 reserved spots for employees, \$1,000  $((50/500) \times \$10,000 = \$1,000)$  is the amount of total parking expenses that is nondeductible for reserved employee spots under § 274(a)(4). Thus, under § 512(a)(7), K must increase its UBTI by \$1,000, the amount of the deduction disallowed under § 274(a)(4).

## ... Example 2 for Determining Parking

Step 2: The primary use of the remainder of K's parking lot is to provide parking to the general public because 78 percent ( $350/450 = 78$  percent) of the remaining spots in the lot are open to the public. Thus, expenses allocable to these spots are excepted from the § 274(a) disallowance by § 274(e)(7) under the primary use test, and only \$1,000 is subject to the § 274(a)(4) disallowance. Therefore, only \$1,000 of the expenses for the provision of the QTF will result in an increase in UBTI under § 512(a)(7).

## ... Example 2 for Determining Parking

Solution: K will need to add the \$1,000 increase of UBTI under § 512(a)(7) to its gross income from unrelated trades or businesses. K is required to file a Form 990-T because the \$1,000 increase to UBTI under § 512(a)(7) meets the filing threshold.



## ... Changes to Substantiation Requirements

The Act repeals the Internal Revenue Service's authority to develop optional reporting procedures for substantiating charitable contributions. As such, taxpayers making any single charitable contributions in the amount of \$250 or more will need to substantiate the contribution with a contemporaneous written acknowledgement in order to be able claim a charitable contribution deduction for such contribution on their tax return.

## ... Changes to Form 990: FASB Presentation

As a result of the change in Presentation of Financial Statements of Not-for-Profit Entities, issued by the Financial Accounting Standards Board (FASB), Form 990 Part X, Lines 27-29 has also been updated to reflect the way not-for-profit organizations classify net assets to be in line with the financial statement reporting changes under the Account Standards Update (ASU).

## ... Changes to Form 990: Schedule B Contributors

A tax-exempt organization – other than a 501(c)(3) organization (including a Section 4947(a)(1) nonexempt charitable trust) or a Section 527 political organization – is no longer required to report the names and address of its contributors on the Schedule B.

## ... Areas of the Tax Cuts and Jobs Act Indirectly Impacting Exempt Organizations

### Positive Changes:

- Repeal of limitation on certain itemized deductions for taxpayers with AGI over certain thresholds.
- Contribution deductibility increased from 50 percent to 60 percent of adjusted gross income (AGI).

## ... Areas of the Tax Cuts and Jobs Act Indirectly Impacting Exempt Organizations

### Negative Changes:

- Significant increase in the standard deduction.
- State and Local Tax (SALT) deduction limited to \$10k.
- Doubling of indexed estate tax exemption from \$5.5 million to \$11 million.
- Charitable deduction not allowed for amounts paid for college athletic event seating rights.



## ... Areas of the Tax Cuts and Jobs Act Indirectly Impacting Exempt Organizations

Will individuals donate less to charitable organizations if they will not be receiving a tax benefit?

- “Bunching” - doubling of contributions within one year.
- Use of donor-advised funds.
- Retirees, age 70½ or older can transfer money from their IRA to a qualifying charity.
- Avoid capital gains tax on investments by giving stocks or other appreciated assets that have grown in value.

# Questions



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