

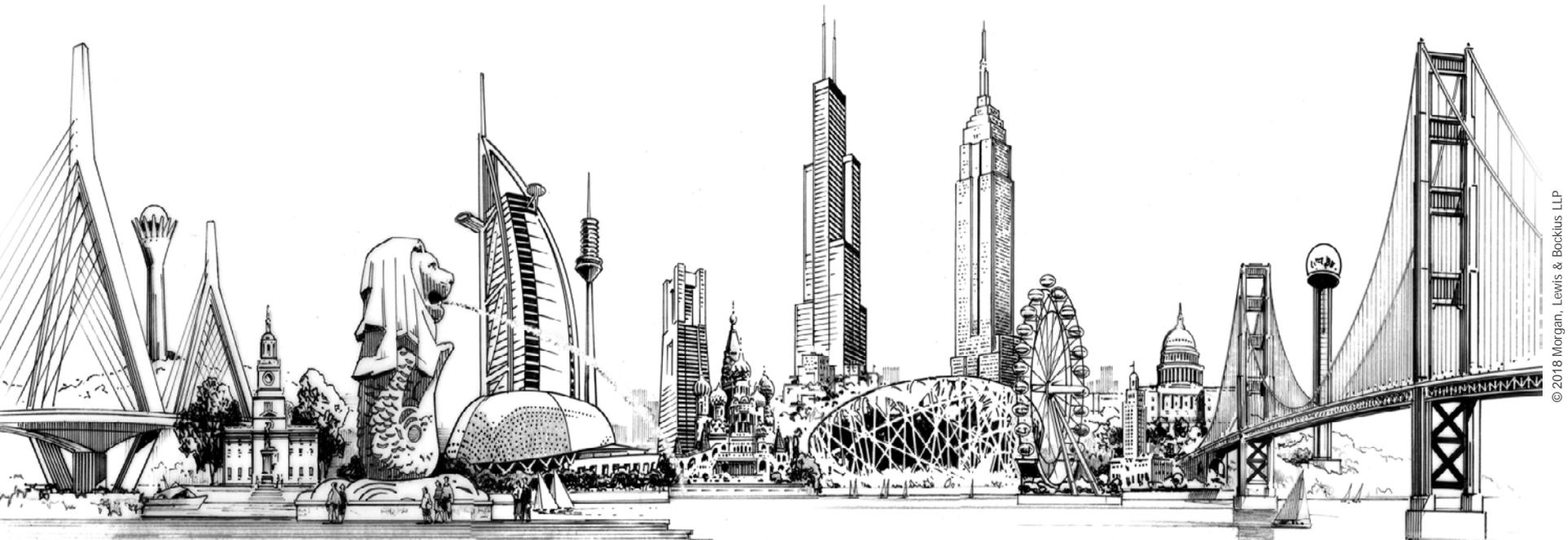
**Morgan Lewis**

# CAPITOL HILL UPDATE AND THE IMPACT ON EXEMPT ORGANIZATIONS

**April 23, 2018, 10:30 am to 11:20 am**

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Alex is a partner in the Tax Practice at Morgan Lewis & Bockius LLP specializing in transactional tax, tax policy, and tax controversy, focusing on tax-exempt organizations of all kinds, including grantmaking foundations, international organizations, colleges and universities, advocacy groups, and many others.

In addition to providing tax advice, he also helps organizations improve their governance and obtain legislation and administrative guidance from the US Treasury, IRS, and Congress.

Before joining Morgan Lewis, Alex served as legislation counsel for the Joint Committee on Taxation of the US Congress, where he advised members of Congress and staff regarding tax policy.

He earned a BA with distinction in philosophy from Yale University and JD and LL.M. in taxation from New York University School of Law where he was editor in chief of the Law Review.

# Key TEO Provisions

- A number of changes that impact charitable giving
- Changes to the calculation of unrelated business taxable income (UBTI)
  - UBTI is increased by the amount of certain fringe benefits
  - Net operating loss deduction can only be taken with respect to the applicable trade or business generating UBTI
- New excise tax on certain compensation paid to highly compensated employees
- New tax on certain college and university endowments

# What Almost Made It Into the Bill?

- Taxation of royalties from name and logo license as UBTI
- Repeal of estate and generation-skipping taxes,
- Elimination of private activity bonds,
- Simplification of the private foundation tax on net investment income,
- Exception for independently operated philanthropic business holdings from the private foundation tax on excess business holdings,
- Requirements on art museums seeking to qualify as private operating foundations,
- Reporting requirements applicable to the sponsoring organizations of donor-advised funds,
- Special exception under the “Johnson Amendment” permitting Section 501(c)(3) organizations to make political statements under certain circumstances,
- Repeal of above-the-line deductions for certain educational expenses and exclusions of certain educational expenses,
- Inclusion of inflation in the calculation of the charitable mileage rate,
- Applicability of UBIT to government pension plans,
- Modification to the UBIT exception for fundamental research organizations
- Ability to deduct tuition paid for religious instruction

# Charitable Giving

- Increases the standard deduction to \$24,000 for joint filers (and surviving spouses), \$18,000 for head-of-household filers, and \$12,000 for individual filers.
  - Amounts adjusted for inflation based on chained consumer price index (C-CPI-U).
- Retains the charitable contribution deduction for taxpayers able to claim itemized deductions.
- Increases the limitation for cash contributions (but not stock) to public charities (and certain private foundations) to 60% of the donor's adjusted gross income (computed without net operating losses) for taxable years beginning after December 31, 2017 and before January 1, 2026.
- Eliminates charitable deduction for donations to educational institutions that entitle the donor to the right to purchase tickets for athletic events (section 170(l)), regardless of the value of the seating rights or the amount of the contribution.

## Charitable Giving (cont'd)

- Repeals the “Pease” limitation, which sets an overall limit or “haircut” on itemized deductions including charitable contribution deductions for taxable years beginning after December 31, 2017 and before January 1, 2026.
- Doubles the amount eligible for exclusion from estate, gift, and generation-skipping taxes to \$10 million, indexed for inflation occurring after 2011. The change applies to taxable years beginning after December 31, 2017 and before January 1, 2026.

# Unrelated Business Income Tax: Fringe Benefits

- New Section 512(a)(7) increases unrelated business taxable income (UBTI) by the amount of certain fringe benefits for which a deduction would be denied under Section 274 if the employer were taxable.
  - The purpose of the rule is to achieve parity between taxable and tax exempt employers.
  - The specific items listed in Section 512(a)(7) include: qualified transportation fringe benefits, any parking facility used in connection with qualified parking, and on-premises athletic facilities to the extent a deduction is disallowed.
  - Section 274, however, does not deny a deduction for the use of on-premises athletic facilities due to a last minute switch between the House and Senate versions of the rule.
  - Doesn't apply to the extent that the amount is directly connected with a regularly carried-on unrelated trade or business.

# Unrelated Business Income Tax: Siloing

- Section 512(a)(6) requires an organization with more than one unrelated trade or business to compute UBTI separately with respect to each trade or business and without regard to the specific deduction allowed under Section 512(b)(12).
  - A net-operating-loss deduction is allowed only with respect to a trade or business from which the loss arose.
  - It is unclear how broadly a line of business will be defined for purposes of UBTI loss siloing.
  - Courts have long held that investing for one's own account is not a trade or business.
  - Will UBTI arising from debt-financed income be trapped in its own silo? Or will it be able to be used to offset income from any trade or business?
  - What trade or business should UBTI from fringe benefits be allocated to?

# Executive Compensation

- Section 4960 imposes a 21% excise tax on an employer with respect to (1) compensation in excess of \$1 million as well as (2) excess parachute payments paid by an applicable tax-exempt organization to a covered employee.
- What is an applicable tax-exempt organization?
  - Organizations exempt from tax under Section 501(a) (e.g., 501(c)(3), (c)(4), (c)(6))
  - Farmer cooperatives described in Section 521(b)(1)
  - Organizations with income excluded from tax under Section 115(1)
  - Political organizations described in Section 527(e)(1)

# Executive Compensation (cont'd)

- Who is a covered employee?
  - An employee (including a former employee) who is one of the five highest-paid employees for the taxable year or who was a covered employee of the organization (or a predecessor) for any preceding taxable year beginning after December 31, 2016.
- Special rules apply to compensation paid by related entities.
  - Treasury may refer to Section 1.414(c)-5 of the Treasury Regulations which provides that “control” means a person or entity with power to appoint 80% of the governing body.

# Executive Compensation (cont'd)

- How is “compensation” defined?
  - All remuneration paid for services performed as determined for income tax withholding purposes, plus amounts required to be included in gross income under Section 457(f) at the time they are no longer subject to a substantial risk of forfeiture
  - Excludes:
    - Any designated Roth contribution as defined under Section 402A(c)
    - Compensation paid to a licensed medical professional (including veterinarians) for the performance of medical or veterinary services
- When deferred compensation is “compensation” under 4960
  - 457(b) plan – when paid or made available
  - 457(f) plan – upon vesting
    - May inadvertently trigger excise tax

# Executive Compensation (cont'd)

- What is an excess parachute payment?
  - The excess of (a) any payment (in the nature of compensation) to or for the benefit of a covered employee that is contingent on the employee's separation, and the aggregate present value of all payments is at least three times the base amount, over (b) the portion of the base amount allocated to such payment.
  - The base amount is the average annualized compensation includible in gross income for the five taxable years ending before the date of the employee's separation.
  - Excludes payments under a qualified retirement plan, a simplified employee pension plan, a simple retirement account, a tax-deferred annuity, and an eligible deferred compensation plan of a state or local government employer, as well as payments to licensed medical professionals for the performance of medical or veterinary services and to an individual who is not a highly compensated employee under Section 414(q).

# Endowment Excise Tax

- Section 4968 imposes a 1.4% excise tax on the net investment income of each applicable educational institution.
  - Net investment income corresponds to the private foundation definition and generally includes interest, dividends, rents, royalties (and income from similar sources), and capital gain net income, reduced by expenses incurred to earn this income.
- An applicable educational institution is defined as an eligible educational institution within the meaning of Section 25A(f)(2):
  - That had at least 500 **tuition-paying** students during the previous taxable year, more than 50% of whom are located in the United States;
  - That is not described in the first sentence of Section 511(a)(2)(B) (relating to state colleges and universities); and
  - The aggregate fair market value of the assets of which at the end of the preceding taxable year (other than those used directly in carrying out the institution's exempt purposes) is at least \$500,000 per student.
- The words “tuition-paying students” was added in the Bipartisan Budget Act to ensure that Berea College in Kentucky was not subject to the tax.

## Endowment Excise Tax (cont'd)

- The number of students of an institution (including for purposes of determining the number of students at a particular location) shall be based on the daily average number of full-time students attending such institution (with part-time students taken into account on a full-time student equivalent basis).
- The excise tax includes the net investment income and assets of related organizations—such as controlling and controlled organizations and supported and supporting organizations.

# Additional Provisions

- Closes a loophole that some taxpayers had attempted to exploit by amending the donee organization's Form 990 to claim that a charitable contribution had been substantiated in a prior year.
- Requires taxpayers to include the interest on advance refunding bonds in taxable income.

# Technical Corrections?

- Technical corrections is special type of legislation that is deemed to have no revenue cost to the US Government.
- Technical corrections align text of the statute with legislative intent of Congress.
- The original revenue estimate is deemed to capture the congressional intent, so scoring technical corrections would be double counting.
- Technical corrections require unanimous consent by majority and minority staff of the House Committee on Ways and Means and the Senate Finance Committee, and consent from Treasury.
- Technical corrections require 60 votes in the Senate and cannot be passed via the 50-vote budget reconciliation procedure.

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