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Hot Topics in Taxation

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Hot Topics in Taxation

- Tax Reform
  - State of Play
  - Charitable Deduction & Tax Rate Changes
  - New Rules for Exempts
- Other topics
  - Recent Developments
  - Program-Related Investments

Charitable Deduction Changes

- Increased standard deduction ($24,000 for a married couple) and repeal of several other deductions decreases taxpayers itemizing deductions and thus incentive to give
- Increased threshold for estate tax decreases significance of estate/gift tax charitable deductions
- AGI limit for cash gifts increased to 60%
- Repeal of section 68 overall limitation on itemized deductions
- Senate: No deduction for amounts paid for the right to purchase athletic tickets (current law allows 80% deduction)

Business Tax Rate Changes

- Top marginal corporate rate 20%
- Top marginal individual rate 39.6% House/38.5% Senate
- Special limitation to 25% maximum rate on “business income”
  - won’t reduce tax on income from some service-oriented professions (e.g., lawyers, investment advisors)
  - in general, it treats 30% of active business income as subject to reduced rate; other income remains at higher rates

Potential Impacts on Planning

- If estate tax disappears, focus shifts to income tax
- New rate disparity on pass-through income held by individuals and held by charity (non-trust charities will have 20% rate), vs individual rates often above 30%
- Less disparity between individual and UBIT capital gains rates
- S corporation gifts: charities now taxed only 20% on subsequent sale
- Trust structure for receiving S corporation gifts still more efficient (assuming 23.8% capital gains rate, gift to charitable trust followed by 60%-deductible distribution of cash to another charity achieves 9.53% tax rate)

House: UBIT for "Super-Exempts"

- UBIT applies to <u>ANY</u> organization exempt under section 501(a), even if they are also exempt or exclude their income under another provision.
- Section 115 government-related organizations
  - What about states themselves?
  - Tribes, state pension funds, foreign governments?

Other UBIT reforms

Senate

- Losses from one unrelated business cannot offset income from another
- Removes exclusion for trademark / logo royalties (e.g., affinity credit cards)

House

- Certain organizations primarily engaging in fundamental research made publicly available will not be automatically exempt from tax on any other research (e.g., applied research or research not made public)
- If tax-exempt pays for certain fringe benefits that it could not deduct if it were a for-profit, it must increase its UBIT by the amount of the payment
  - Qualified transportation fringes
  - Qualified parking parking facility costs
  - On-premises athletic facility

House: Private Foundation Excise Tax

- Tax on net investment income of private foundations is currently either 1% or 2%, depending on current vs. historic spending level
- Would move to a flat1.4%

Crackdown on "Private Museums"

- Organizations operating art museums as a substantial activity can't qualify as private operating foundations unless the museum is open to the public during normal business hours for at least 1,000 hours during the taxable year.
- If an organization fails this test, it is:
  - Subject to the 5% payout requirement
  - Unable to offer FMV deductions for artwork contributions

New Excise Tax on College Endowments

- 1.4% of the net investment income of certain private colleges (markup includes related organizations)
- Private colleges subject to new tax if:
  - "eligible education institutions" (e.g., eligible for federal funding)
  - have 500 or more students
  - have over $250,000 in endowment per student

Senate: Expanded Excess Benefit Transactions

- Current: 25% tax on disqualified person on amount of excess benefit transaction (501(c)(3) and (4))
- Expanded to 501(c)(6) and 501(c)(5) organizations
- New 10% tax on organization
- Rebuttable presumption procedures—independent board approval based on comparability data—no longer shift burden proof, but can avoid 10% penalty
- CIOs and coaches are disqualified persons
- No safe harbor for managers approving based on professional advice

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Executive Compensation

- New 20% excise tax on tax-exempt if it pays compensation to an individual over $1,000,000
- Not just for 501(c)(3) and 501(c)(4)
- Applies to compensation paid by related for-profit entities
- Parallel to denial of deduction for publicly traded companies paying compensation over $1,000,000
- 409B (struck from current House markup) could accelerate vesting of nonqualified deferred compensation

House Exception for Excess Business Holdings Tax

- Allows private foundation to hold 100% ownership in business if:
  - stock is received as a gift
  - all net operating income (less taxes and a "reasonable reserve for working capital and other business needs") is distributed annually
  - Substantial contributors & family can't be involved in business (or get loans from it)
  - Family of substantial contributors are not a majority of the foundation's board

House: “Johnson Amendment”

- Churches will not lose exempt status because of political statements from the pulpit if:
  - statement is in the ordinary course of activities
  - only de minimis marginal costs are associated with political speech
- Markup extends this to all section 501(c)(3) organizations, but makes it temporary (2019-2023)

House: Increased DAF Reporting

- DAF sponsors must:
  - report average spending levels from such funds
  - provide copies of policies with regard to frequency and minimum level of distributions

- Ongoing interest in whether DAFs are being used to avoid PF payout requirements

Tax-Exempt Bonds

- House bill eliminates exclusion of interest on "private activity bonds"
- This includes qualified 501(c)(3) bonds

Other Recent Developments

- New rules on grants to foreign entities from private foundations: Rev. Proc. 2017-53 provides guidelines for what written advice from a qualified tax practitioner should include
- Assignment of Income: Increased audits of donations closely followed by sales.

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