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TAX ALERT

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Key Tax Reform Provisions Affecting Tax Exempt Organizations

Amy Bibby, Partner | DHG Tax

On December 22, 2017, the tax reform law commonly referred to as *H.R. 1 Tax Cuts and Jobs Act* was signed by President Trump. Although many have focused on the effects of this bill on the for-profit and individual sector, the Act provides many changes that affect the tax exempt sector. Below are the key provisions that may affect tax exempt organizations.

1. Unrelated Business Income

There is a significant change to how unrelated business income (UBI) is calculated. Under current law, UBI is aggregated from all unrelated activities whether they are profitable or not profitable. Under the final law, organizations will report UBI separately for each unrelated trade or business, in effect requiring profitable business lines to be taxed separately without the benefit of offsetting losses from unprofitable lines of business.

2. Excise Tax for Colleges & Universities on Net Investment Income

A new 1.4 percent excise tax will be imposed on 501(c)(3) private colleges and universities on net investment income attributable to assets that exceed certain levels (i.e $500,000 of held assets per student). Assets used in the exempt purpose are excluded from this calculation. Assets and net investment income of a related organization (for example a university's foundation) are treated as assets and net investment income of the institution for these purposes. Also note that this provision does not apply to state/governmental colleges and universities.

3. Medical Expense Deductions

Although the initial House bill proposed elimination of the medical expense deduction for individuals, however the final tax bill signed into law retains the medical expense deduction and lowers the adjusted gross income floor from 10% to 7.5% for the 2017 and 2018 tax years. If eliminated, loss of this deduction would have adversely affected residents that paid entrance fees upon entering a continuing care retirement community.

4. Charitable Contributions

Charitable contributions included on an individual's tax return as an itemized deduction are subject to deduction limits based on the individual's Adjusted Gross Income (AGI). The new tax law increases the AGI limit for cash contributions to most charitable organizations from 50 percent to 60 percent. This allows individuals to deduct on their individual income tax return larger cash contributions to public charities. However, the charitable sector may see more of an effect on contribution revenue due to the increase in the individual standard deduction. Presumably, fewer individuals will claim itemized deductions and therefore may be less incentivized to make charitable contributions for which they will not receive a tax benefit.

5. Johnson Amendment

The Johnson Amendment is a provision in the current U.S. tax code that prohibits all 501(c)(3) organizations from endorsing or opposing political candidates. The House version of the bill called for the elimination of the Johnson Amendment. However the final law does not include this elimination, leaving intact the prohibition for 501(c)(3) organizations from making political statements.

6. Bonds

The House bill proposed significant restrictions on private activity bonds which would have halted 501(c)(3) tax exempt bond activity. In the final law, private activity bonds were spared, allowing their interest to remain tax exempt. However, advanced refunding's are no longer allowed.

7. Compensation

Under the new law, an excise tax of 21 percent is due on compensation over $1 million paid to covered employees. Covered employees are the five highest compensated employees for the tax year of a tax exempt organization plus any employees who were covered employees in any preceding taxable year beginning after December 31, 2016. The final law provided an important exception for the healthcare sector, exempting from the excise tax compensation paid to employees that are licensed medical professionals providing medical services.

Amy Bibby
Partner, DHG Tax
828.236.5797
amy.bibby@dhgllp.com