Update on Developments under the Tax Cuts and Jobs Act

ABA Section of Taxation, Exempt Organizations Committee
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*Disclaimer: The content of this presentation is not intended as a statement of the views of Victoria Judson, Elinor Ramey, the Department of Treasury, the Office of Associate Chief Counsel, or the Internal Revenue Service.
Recap of EO provisions of the TCJA

- **Section 13602 - Excise Tax on Tax-Exempt Organization Executive Compensation**
  - Created new Code section 4960
  - Imposes a 21% excise tax on remuneration in excess of $1 million paid to a covered employee by an applicable tax-exempt organization
    - *Applicable tax-exempt org* = org exempt under section 501(a), farmers' cooperative org in section 521(b)(1), org that has income excluded from taxation under section 115(1), or political org described in section 527(e)(1)
    - *Covered employee* = one of the 5 highest compensated employees of the org for the taxable year, or a covered employee for any preceding taxable year after December 31, 2016
    - *Remuneration* = wages (as defined in section 3401(a)). Includes amounts from related organizations
      - However, it does not include amounts paid to a licensed medical professional (including a veterinarian) for the performance of medical or veterinary services by such professional
Recap of EO provisions of the TCJA

• Section 13602 - Excise Tax on Tax-Exempt Organization Executive Compensation
  • Also imposes an excise tax on parachute payments exceeding the portion of the base amount (defined as the average annual compensation of the employee for the five tax years before the employee’s separation from employment) that is allocated to the payment.
    • The tax on excess parachute payments applies only to payments made to covered employees who are highly compensated (within the meaning of §414(q)).
Recap of EO provisions of the TCJA

• Section 13701 - Excise Tax Based on Investment Income of Private Colleges & Universities and Section 41109 of the Bipartisan Budget Act
  • New code section 4968
  • Imposes a 1.4% excise tax on net investment income of certain private colleges and universities and their related organizations.
    • Applies only to private institutions that:
      • have more than 500 students,
      • have at least 50% of their students located in the United States, and
      • have assets of at least $500,000 per full-time student (not including assets used directly by the institution in carrying out the institution’s educational purpose).
  • The Bipartisan Budget Act of 2018 modified the requirements and added “tuition paying” to the requirement:
    • More than 500 tuition-paying students and
    • At Least 50% of their tuition-paying students located in the United States
  • Net Investment Income = determined under rules similar to 4940(c)
  • Amounts from certain related organizations are included in this calculation
Recap of EO provisions of the TCJA

• Section 13702 – Unrelated Business Taxable Income Separately Computed for Each Trade or Business Activity
  • Amended section 512 to create section 512(a)(6)
  • Organizations that carry on more than one unrelated trade or business must calculate their unrelated business taxable income, including for purposes of determining any net operating loss deductions, separately for each unrelated trade or business
Recap of EO provisions of the TCJA

- Section 13703 – Unrelated Business Taxable Income Increased by the Amount of Certain Fringe Benefits for which a Deduction is Disallowed
  - Amended section 512 to create section 512(a)(7)
  - Organizations must increase their unrelated business taxable income by the amount disallowed under section 274 for qualified transportation fringes, any parking facility used in connection with qualified parking, and any on-premises athletic facility
    - To be included in UBTI, the expenditure must be for one of the enumerated items (qualified transportation fringes, parking facility used in connection with qualified parking, or on-premises athletic facility) **AND** disallowed under section 274
      - This is important because there is a mismatch between the language in 512(a)(7) and what was disallowed under section 274
Recap of EO provisions of the TCJA

• Section 13704 – Repeal of Deduction for Amounts Paid in Exchange for College Athletic Event Seating Rights
  • Eliminated section 170(l), which previously allowed for an 80% deduction for contributions for amounts paid in exchange for college athletic event seating rights
Recap of EO provisions of the TCJA

• Section 13705 – Repeal of Substantiation Exception in Case of Contributions Reported by Donee
  • Eliminated section 170(f)(8)
    • That section previously allowed for a substantiation exception for donee reported contributions
Recap of the TCJA – Other Sections that Could Impact EOs

• Section 13302 – Modification of Net Operating Loss Deduction
  • Modified the rules for net operating losses under section 172
    • The NOL deduction is now capped at 80%
    • The NOL carryback was eliminated, and
    • The NOL carryforward is now indefinite
  • Applies to NOLs arising in tax years ending after Dec. 31, 2017

• This section impacts EOs with unrelated business taxable income and how they calculate it, particularly with the 512(a)(6) silo-ing rules.
Recap of the TCJA – Other Sections that Could Impact EOs

• Section 13001 – 21-Percent Corporate Tax Rate
  • Modified the corporate tax rates to a flat 21%
    • Previously, the rates could be as low as 15% for a small organization with less than $50,000 of income and as high as 35% for organizations with income over $10,000,000
  • This section impacts EOs with unrelated business taxable income.
Recap of the TCJA – Other Sections that Could Impact EOs

- **Section 11021 – Increase in Standard Deduction**
  - Increases the standard deduction to $12,000 for individuals, to $24,000 for couples, and $18,000 for heads of households

- **Section 11023 – Increased Limitation for Certain Charitable Contributions**
  - Modifies section 170 and increases the 50% limitation for cash contributions to public charities and certain private foundations to 60% for contributions made after Dec. 31, 2017 but before Jan. 1, 2026

- **Section 11046 – Suspension of Overall Limitation on Itemized Deductions**
  - Repeals the “Pease limitation” on itemized deductions that limited deductions for upper-income individuals. In 2017, the limitation applied at an AGI threshold of $261,500 for a single taxpayer. Above that threshold, a taxpayer’s itemized deductions would be reduced by the lesser of (a) 3 percent of AGI above the applicable threshold; or (b) 80 percent of the amount of itemized deductions otherwise allowable for the tax year
The Bluebook for the TCJA (JCS-1-18), released on Dec. 20, 2018, provides additional technical information of the law and its provisions.

Section 4960 – Excess exec. comp.

- A technical correction may be necessary to reflect the intent that an applicable organization includes State colleges & universities
- A technical correction may be necessary to reflect the intent that the related organization rules apply to excess parachute payments and to determining covered employees
- A technical correction may be necessary to reflect the intent that the liability for the excise tax for excess parachute payments should be allocated among related organizations in the same manner as the liability for the excise tax on remuneration
- Teaching, research, or acting as dean, officer, or board member of a hospital are not “direct medical services” the remuneration for which would be excluded
- The excise tax applies to remuneration when the right to the remuneration is no longer subject to a substantial risk of forfeiture (as defined in section 457(f)(3)(B)), without regard to when such remuneration is actually received or otherwise required to be included in gross income as wages under section 457(f) or otherwise. For example, even though remuneration may be vested in one year but paid within the first two and one-half months of the following year such that the income inclusion is required in the year paid, the Blue Book suggest the remuneration should be treated as paid for this purpose in the year when vested.
- The excise tax cannot be avoided if an individual who is an employee is classified as an independent contractor and paid as such, or if payment is made to an LLC owned all or in part by an employee or to or by a person or organization unrelated to an applicable tax-exempt organization.

Section 4968 – Excise tax on net investment income of private universities

- Notes that if the assets of a related organization are earmarked or restricted for the educational institution, then they would be treated as assets of the educational institution. But, if the assets of the related organization is held for unrelated purposes then the assets are disregarded
JCT Blue Book on the TCJA

• The Bluebook for the TCJA (JCS-1-18), released on Dec. 20, 2018, provides additional technical information of the law and its provisions

• Section 512(a)(6) – Separate calculation of UBTI
  • Notes that it is not intended that an organization would be required to allocate its deductible charitable contributions among its various unrelated trades or businesses
  • States that it is intended for the Secretary to consider whether it would be appropriate in certain cases to permit an organization that maintains an investment portfolio to treat multiple investment activities as one unrelated trade or business

• Section 512(a)(7) – UBTI increased by amount of disallowed fringe benefit expenses
  • Confirms that amounts for on-premises athletic facilities are not included in this provision due to the language that remained in section 274
  • Notes that the $1,000 specific deduction is still available to offset unrelated business taxable income resulting from this provision

• Section 170(b)(1)(G)
  • Notes that the 60% limit for cash contributions is intended to be applied after (and reduced by) the amount of noncash contributions to organizations described in section 170(b)(1)(A) and that a technical correction may be needed to reflect this intent
IRS Guidance Issued on the TCJA

• Notice 2018-55 (June 8, 2018)
  • Provides guidance on section 4968 (the net investment income excise tax on private colleges & universities)
  • Permits a step up in basis to fair market value for assets held as of December 31, 2017
  • After December 31, 2017, rules consistent with section 4940(c) apply
  • Also applies rules similar to section 4940(c) for netting capital gains and losses
  • Comments to the notice were due on or before September 6, 2018
IRS Guidance Issued on the TCJA

- Notice 2018-67 (August 21, 2018)
  - Provided guidance on section 512(a)(6) (UBTI separately calculated), as well as the UBTI treatment of Global Intangible Low-Taxed Income (GILTI)
  - Organizations should use a reasonable, good-faith interpretation in calculating their UBTI and separating their trades or businesses
    - Separating trades or businesses in accordance with six-digit North American Industry Classification System (NAICS) codes will count as a reasonable, good-faith interpretation
  - Organizations may aggregate income from a single partnership that conducts multiple trades or businesses (either directly or through lower-tier partnerships), if the holdings are “qualifying partnership interests”
    - Must meet either a De Minimis Test (constituting no more than 2% of the profits and capital interests in the partnership) or a Control Test (constituting less than 20% of capital interest and providing no control or influence over the partnership)
    - There is a transition rule for partnership interests acquired before August 21, 2018 that do not meet the above tests that allows an organization to treat all income earned from a single grandfathered partnership as income from a single trade or business
IRS Guidance Issued on the TCJA

• Notice 2018-67 (August 21, 2018) continued
  • Proposes that unrelated debt-financed income, income from controlled entities, and insurance income from controlled foreign corporations should be treated as from separate trades or businesses and therefore calculated separately
  • Provides that 512(a)(7) amounts do not constitute a trade or business
  • Makes clear that the IRS will treat GILTI as though it were a dividend, which is similar to how it treats most other income from controlled foreign corporations for unrelated business income purposes
  • Identified that guidance is needed on net operating losses and the allocation of expenses
  • Comments to this notice needed to be submitted on or before December 3, 2018
IRS Guidance Issued on the TCJA

- Proposed regulations on the type of return and time for filing for payments of section 4960, 4966, 4967, and 4968 taxes
  - Issued on November 7, 2018
  - Makes clear that organizations would file the Form 4720
IRS Guidance Issued on the TCJA

• Notice 2018-99 (December 10, 2018)
  • Interim guidance to determine the amount of parking expenses for qualified transportation fringes
  • Permits organizations to use any reasonable method, including the one specified in the notice
  • Third parties:
    • If amounts for parking are paid to a third party, then the increase in UBTI is the total annual cost paid to the third party, up to the current cap of $260 per employee per month. Amounts in excess of $260 are treated as compensation to the employee and excluded from UBTI
  • Organization owned or leased:
    • Notice provides a 4-step safe harbor that looks at:
      1) the percentage of parking spots reserved for employee use
      2) the primary use of the remaining parking spots
      3) the percentage of parking spots reserved for non-employees, and
      4) a reasonable allocation of remaining parking spots
IRS Guidance Issued on the TCJA

• Notice 2018-99 (December 10, 2018), continued
  • The value of the parking is not a reasonable method because the section 274 deduction is disallowed regardless of value
  • Expenses include repairs, maintenance, utility costs, insurance, property taxes, interest, removal of snow, ice, leaf and trash, cleaning, landscape costs, parking lot attendant expenses, security, rent or lease payment or a portion of rent or lease payments
  • Expenses do not include depreciation
IRS Guidance Issued on the TCJA

• Notice 2018-100 (December 10, 2018)
  • Provides a waiver of the addition to tax under section 6655 for underpayment of estimated income tax for certain organizations
  • The underpayment must result from the changes to the tax treatment of qualified transportation fringes under section 512(a)(7)
  • To qualify, the tax-exempt organization:
    • Must provide qualified transportation fringes (as defined in section 132(f)) to an employee for which estimated income tax payments, affected by changes to sections 274 and 512 under the Act, would otherwise be required to be made on or before December 17, 2018,
    • Was not required to file a Form 990-T, Exempt Organization Business Income Tax Return, for the taxable year preceding the organization’s first taxable year ending after December 31, 2017,
    • Must timely file Form 990-T, and
    • Must timely pay the amount reported for the taxable year for which relief is granted.
  • Organizations that do not qualify for relief under this notice may avoid the addition to tax if they meet one of the safe harbor or exception provisions under section 6654 or section 6655
IRS/Treasury Priority Guidance Plan

• Released November 8, 2018
• Part 1 – Focuses on TCJA Implementation
  • Guidance on computation of unrelated business taxable income for separate trades or businesses under section 512(a)(6), as added by section 13702 of the TCJA
    • Note that under the Exempt Organizations section, there is an item for guidance under section 512 regarding methods of allocating expenses relating to dual use facilities
  • Guidance on the excise tax on excess remuneration paid by “applicable tax-exempt organizations” under new section 4960, as added by section 13602 of the TCJA
  • Regulations on the excise tax on net investment income of certain private colleges and universities under new section 4968, as added by section 13701 of the TCJA
Part 1 – TCJA Implementation Continued

- Regulations under sections 6011 and 6071 on filing requirements for various chapter 42 excise taxes added by sections 13602 and 13701 of the TCJA and other legislation
- Regulations under section 170 providing rules governing the availability of the charitable contribution deduction when a taxpayer receives or expects to receive a state or local tax credit
- Guidance under section 274 concerning qualified transportation fringe benefits, including the application of new section 512(a)(7)
IRS Form Changes

• Draft Form 990 and instructions
  • New lines 15 and 16 on Part V for the excise taxes under 4960 and 4698
  • Additional information and a worksheet contained in the instructions

• Draft Form 990-T and instructions
  • Amounts from separate trades or businesses are calculated on a new Schedule M
  • Transportation fringe benefits are taken into account on Part III after taking into account other deductions
  • The Form and Instructions still leave some questions about the ordering and allocation of various deductions with new UBTI rules because of how Part II and Part III of the Form are structured:
    • The Form seems to indicate that post-2017 NOLs will be used before pre-2018 NOLs, which goes against the first in, first out rule
    • It appears that charitable contributions are allocated to trades or businesses and deducted “within” silos instead of against aggregate UBTI in Part III
    • It does not appear that you can apply deductions (such as the state and local tax deduction) against taxable amounts under 512(a)(7)

• Draft Form 4720
  • Added new lines and schedules to report and calculate the excise taxes under 4960 and 4698
  • The instructions contain a tip that states “a governmental entity that is not exempt from tax under section 501(a) as a section 501(c)(3) organization and does not exclude income under section 115(1) is not an ATEO [applicable tax-exempt organization] for purposes of section 4960.”