

Tax Reform Provisions Affecting Exempt Organizations

This Alert, which is one of a series from Cozen O'Connor dealing with the recently enacted federal tax reform legislation, summarizes the salient provisions of the new law affecting tax-exempt organizations.

Perhaps most noteworthy are the proposals that did **not** survive the legislative process. For example, **none** of (i) repealing the income tax exemption of interest on § 501(c)(3) bonds; (ii) imposing the unrelated business income tax regime on royalties from the licensing of an organization's name or logo, or on certain investment income of qualified retirement plans of state and local governments; (iii) permitting certain political speech by § 501(c)(3) organizations; or (iv) simplifying the rate structure on the net investment income of private foundations, among other provisions, was enacted, although their inclusion in earlier versions of the legislation suggests that these and similar provisions might be revisited in the future.

Instead, only a few of the tax reform proposals dealing with exempt organizations were enacted, and the two most important of those provisions that are of general applicability are summarized below.

Computation of Unrelated Business Taxable Income

In general, an exempt organization is subject to tax on the income it derives from carrying on a trade or business that is not substantially related to its exempt purpose. If the organization derives such unrelated business taxable income, or UBTI, from several business activities, Treasury Regulations currently allow netting of income and losses from all such business activities in determining the organization's aggregate UBTI.

Effective, however, for taxable years beginning after 2017, the new law requires the separate computation of UBTI from each trade or business and proscribes the netting of losses from one trade or business activity against the income of another trade or business. Mitigating the impact of this change somewhat is a transition rule that permits pre-2018 net operating losses to be used against any UBTI in subsequent years, and the reduction to 21 percent of the income tax rate applicable to corporations.

In another UBTI change, effective for amounts paid or incurred after 2017, certain employer-paid qualified transportation and parking fringe benefits and the expenses of certain on-premises athletic facilities and parking facilities will be subject to UBTI. Treasury Regulations clarifying the scope of and possible exceptions to the parking and athletic facilities rules are to be prescribed.

Excise Tax on Certain Compensation Paid by Exempt Organizations

The law adds new Code Section 4960 that imposes on most exempt organizations, including § 501(c)(3) organizations, a 21 percent excise tax on (i) remuneration in excess of \$1 million paid to a covered employee during the organization's year and (ii) certain excess parachute payments paid to a covered employee (other than one who is not a highly compensated employee), whether or not in excess of \$1 million. A parachute payment for this purpose is a payment in the nature of compensation that is contingent on the covered employee's separation from service, and the excise tax applies generally to payments in excess of a base amount if the present value of the separation payments equals or exceeds three times the base amount. An exception applies for amounts paid to licensed medical professionals in connection with the performance of medical services.

A covered employee is one of the organization's five highest compensated employees for the year or a person who was a covered employee in a previous year, whether or not an officer of the



Dennis L. Cohen

Co-Chair, Tax

dcohen@cozen.com
Phone: (215) 665-4154
Fax: (215) 701-2454

Related Practice Areas

- Tax

organization. Remuneration paid by a related organization is aggregated with the amounts paid by the applicable tax-exempt organization for this purpose.

Tax on Investment Income of Certain Private University Endowments

Effective for years beginning in 2018, a new 1.4 percent excise tax is imposed on the net investment income of private colleges and universities with at least 500 students, more than half of whom are located in the United States, and whose assets, other than those used in carrying out the school's exempt purposes, are at least \$500,000 per student. The investment income and assets of related organizations are included for this purpose. It is expected that net investment income will be determined in a manner similar to the way in which it is measured for purposes of the tax on the investment income of private foundations, and that future regulations will define which assets are used in carrying out the school's exempt purposes.

For further information about these or other provisions of the Tax Cuts and Jobs Act, please contact a member of the Cozen O'Connor Tax Department: Dennis L. Cohen at dcohen@cozen.com or 215-665-4154, Thomas J. Gallagher at thomasgallagher@cozen.com or 215-665-4656, Rory Moore at rorymoore@cozen.com or 215-665-4658, Richard J. Silpe at rsilpe@cozen.com or 215-665-2704, or Joshua C. Weinberger at jweinberger@cozen.com or 215-665-2173.