



The Tax Act of 2017: What Just Happened? And What Does It Mean for Charities?

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The Tax Act of 2017: H.R. 1

- “The Tax Cuts and Jobs Act” short title was stricken
 - “An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018”
- Passed through “reconciliation” process
 - 51 – 48 in the Senate
 - 227 – 203 in the House
- Speedy process:
 - First introduced in the House on November 2
 - Signed into law on December 22

Rate Cuts

- Corporations – lowers tax rate to 21%
- Partnerships – partners get 20% deduction for certain pass-through business income (but not lawyers)
- Temporarily lowers rates and expands brackets for many individuals
- Trusts – still taxed at individual rates, generally higher than corporate rates

How will this impact people?

- “Overall, the combined effect of the change in net federal revenues and spending is to decrease deficits (primarily stemming from reductions in spending) allocated to lower-income tax filing units and to increase deficits (primarily stemming from reductions in taxes) allocated to higher-income tax filing units.”
 - Letter from Keith Hall, Congressional Budget Office, to Hon. Bernie Sanders, “Distributional Effects of Changes in Taxes and Spending Under the Conference Agreement for H.R. 1, Legislation to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018,” Dec. 21, 2017 available at <https://www.cbo.gov/system/files/115th-congress-2017-2018/reports/53429-distributionhr1.pdf>

How will this impact people?

- “JCT has estimated that federal budget deficits would be reduced by about \$318 billion by eliminating the penalty associated with the individual mandate. Those effects would occur mainly because fewer people would be enrolled in Medicaid and nongroup health insurance: Healthier people would be less likely to obtain insurance; especially in the nongroup market, the resulting increases in premiums would cause more people to not purchase insurance. Lower enrollment would reduce federal costs for premium tax credits, Medicaid, cost-sharing reduction payments, and the Basic Health Program and would increase Medicare spending. Without the effects of the individual mandate penalty, none of those changes would occur.”
 - Letter from Keith Hall, Congressional Budget Office, to Hon. Orrin Hatch, “Distributional Analysis of the Tax Cuts and Jobs Act, as Ordered Reported by the Senate Committee on Finance on November 16, 2017, Excluding the Effects of Eliminating the Individual Mandate Penalty,” Nov. 27, 2017 available at <https://www.cbo.gov/system/files/115th-congress-2017-2018/reports/53349-distributionalanalysisletter.pdf>

CBO Distributional Analysis of H.R. 1

Allocation of Changes in Net Federal Revenues and Spending Under H.R. 1

Millions of Dollars

Income Category	2019	2021	2023	2025	2027
Less than \$10,000	1,530	5,890	7,540	8,790	10,120
\$10,000 to \$20,000	150	8,120	10,700	11,320	16,290
\$20,000 to \$30,000	-1,090	7,910	9,440	11,430	17,100
\$30,000 to \$40,000	-4,770	310	2,490	2,840	7,850
\$40,000 to \$50,000	-6,450	-2,590	-1,240	-590	5,510
\$50,000 to \$75,000	-23,050	-18,760	-14,910	-14,380	4,030
\$75,000 to \$100,000	-22,580	-21,030	-17,090	-17,240	-1,720
\$100,000 to \$200,000	-70,690	-65,880	-50,780	-49,790	-7,600
\$200,000 to \$500,000	-65,650	-62,040	-47,250	-48,140	-6,680
\$500,000 to \$1,000,000	-23,990	-21,800	-14,180	-13,790	-3,300
\$1,000,000 and over	-36,940	-30,130	-10,160	-9,960	-8,920
Total, All Taxpayers	-253,500	-200,000	-125,440	-119,500	32,690

Sources: Staff of the Joint Committee on Taxation and the Congressional Budget Office.

Amounts are for calendar years and exclude effects of several provisions, including doubling the exemption allowed under estate and gift taxes.

Components do not add to totals due to rounding.

A decrease in federal deficits, such as an increase in taxes or a decrease in spending, is shown as a positive value. An increase in federal deficits is shown as a negative value.

Charitable Contributions

- Standard deduction increased to \$12,000 (single)/\$24,000 (joint)
 - \$18,000 for head-of-household filers
 - Inflation adjustments based on chained consumer price index
- Retains the charitable contribution deduction for taxpayers able to claim itemized deductions.
- Reduces or eliminates many other itemized deductions
 - Mortgage interest – limit to mortgages of \$750,000
 - State/local taxes – limit to \$10,000
 - Note medical expenses retained - lowers threshold to 7.5% for 2018 only
- Eliminates “Pease limitation”

Charitable Contributions (con't)

- Temporarily increases the limitation for cash contributions to public charities (and certain private foundations) to 60% of the donor's adjusted gross income (AGI) (computed without net operating losses) through 2025.
- Eliminates the charitable deduction for donations to educational institutions if the donor receives the right to purchase tickets for athletic events (section 170(l))
- 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.

Taxes on Tax-Exempt Organizations

- Unrelated Business Income Tax (UBIT)
 - UBIT on amounts spent on certain fringe benefits
 - UBI calculated separately for each trade or business
- New excise tax on certain employee compensation
 - Annual compensation over \$1,000,000
 - “Parachute payments” more than 3 times base compensation
- New endowment excise tax for certain colleges and universities
 - Aggregates income/assets of related organizations, including supporting organizations

UBIT – Fringe Benefits

- New §512(a)(7) increases unrelated business taxable income (UBTI) by the amount paid or incurred for certain fringe benefits if expenses are not deductible by taxable employers due to §274.
 - Specified benefits: qualified transportation fringe benefits, any parking facility used in connection with qualified parking, and on-premises athletic facilities
 - Apparent mismatch of Senate version of §274 and House version of §512(a)(7) – some ambiguity in application

UBIT – Fringe Benefits (cont'd)

- §274(e)(4) provides that on-site gyms meeting specified non-discrimination requirements remain deductible (thus not taxed)
- Guidance is needed regarding application to parking facilities, employee pre-tax salary reduction plans
- Doesn't apply if directly connected with a regularly carried-on unrelated trade or business

UBIT – Separate Calculations

- 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 (\$1000) allowed under Section 512(b)(12).
 - NOL deduction is allowed only against gains from the same trade or business
 - Guidance is needed regarding how broadly a line of business will be defined and what to do with investment and other UBI amounts (e.g., for fringe benefits)

Executive Compensation

- New §4960 imposes a 21% excise tax on an employer with respect to certain amounts paid by an applicable tax-exempt organization to a covered employee if ;
 - Compensation in excess of \$1 million
 - Excess parachute payments

- Applicable tax-exempt organizations:
 - Organizations exempt from tax under §501(a)
 - Farmer cooperatives (§521)
 - Organizations with income excluded from tax under §115(1)
 - Political organizations (§527)

Executive Compensation (cont'd)

- Covered employees
 - Any employee (including a former employee) who is one of the five highest-paid employees for the taxable year
 - Any employee who was a covered employee of the organization (or a predecessor) for a preceding taxable year (beginning after December 31, 2016).

- Special rules apply to compensation paid by related entities.

Executive Compensation (cont'd)

- Compensation includes
 - All remuneration paid for services performed as determined for income tax withholding purposes
 - Amounts included in gross income under Section 457(f) when no longer subject to a substantial risk of forfeiture
- Compensation excludes:
 - Any designated Roth contribution as defined under §402A(c)
 - Amounts paid to a licensed medical professional (including veterinarians) for the performance of medical services
 - For purposes of excess parachute payments, amounts paid to an individual who is not a highly compensated employee under Section 414(q)

Executive Compensation (cont'd)

- 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

Excise Tax on Endowment Income

- New §4968 imposes a 1.4% excise tax on the net investment income of certain educational institutions.
 - 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.
- Educational institutions (defined in §25A(f)(2)) that
 - Had at least 500 students during the previous taxable year, more than 50% of whom are located in the United States;
 - Is not a public institution (described in §511(a)(2)(B)); and
 - Has assets at the end of the preceding taxable year (other than those used directly in carrying out the institution's exempt purposes) of at least \$500,000 per student.

Excise Tax on Endowment Income (cont'd)

- The number of students of an institution (including for purposes of determining the number of students at a particular location) is 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.

Qualified Opportunity Zones

- New incentive to invest in certain low-income communities called Qualified Opportunity Zones (“QOZs”) (§§1400Z-1, 1400Z-2)
- Provides investors with tax benefits if they re-invest the gain from the sale of an asset in Qualified Opportunity Funds (“QOFs”) within 180 days
 - Gain is *excluded* from the investor’s taxable income in the year of the asset sale
 - Gain is *included* in taxable income either when the QOF interest is sold or on 12/31/26
 - Additional benefits if QOF investment is held longer

Qualified Opportunity Zones (cont'd)

- First step: Designate the QOZs (§1400Z-1)
 - Population census tracts that are “low-income communities” must be nominated by a state governor (or DC mayor) to be a QOZ within 90 days of 12/22/17 (can be extended 30 days)
 - Governors may nominate at least 25 QOZs per state (if there are more than 100 low-income census tracts, up to 25% of them may be nominated)
 - Nominated QOZ must be designated by Treasury within 30 days (can be extended 30 more days)

Qualified Opportunity Zones (cont'd)

- Designate the QOZs (cont'd)
 - “Low-income community” has same meaning as in §45D(e).
 - Each low-income census tract in a U.S. possession is deemed to be a QOZ
 - Once designated as a QOZ, the designation lasts until the end of the tenth calendar year beginning on or after the date of designation

Qualified Opportunity Zones (cont'd)

- Second step: Invest in QOFs
 - QOF is a corporation or partnership with a purpose of investing in “QOZ property” that holds 90% or more of its assets in QOZ property
 - Penalty applies if QOZ property is less than 90% of assets
 - “QOZ Property”
 - QOZ stock/p’ship interest – must be domestic entity, purchased for cash after 12/31/17, and be a QOZ business during substantially all of the QOF’s holding period
 - QOZ business property - tangible property purchased after 12/31/2017, for original use by QOF in QOF’s trade/business in a QOZ

Qualified Opportunity Zones (cont'd)

- Benefits to QOF investors
 - Exclude gain from income in year original investment is sold (if invested in a QOF within 180 days)

 - Include in income in year QOF is sold **OR** in 2026
 - Amount of original deferred gain (or QOF value, if lower) *less* QOF basis
 - QOF basis is zero to start.
 - if QOF held 5 years, QOF basis is 10% of the deferred gain (include 90% of deferred gain in income)
 - If QOF held 7 years, QOF basis is 15% of the deferred gain (include 85% of deferred gain in income)

Qualified Opportunity Zones (cont'd)

- Benefits to QOF investors (cont'd)
 - If holding QOF on 12/31/2026, investor must include deferred gain in income and basis in QOF is increased by the amount included in income
 - If QOF held for 10 years, investor can elect to have QOF basis be the FMV of the QOF interest on the date of sale (thus no tax – because no gain – on QOF investment)

Qualified Opportunity Zones (cont'd)

- Guidance from Treasury is needed
 - Statute provides broad regulatory authority to carry out the purposes of the provision, including rules for:
 - Certification of QOFs
 - Ensuring QOF has reasonable reinvestment period
 - Preventing abuse
 - Time is already ticking on this time-limited incentive
 - Several places of ambiguity that regulations can fill in

Other Provisions

- Eliminates §170(f)(8) – an exception to the usual substantiation rules if donee organizations report the donor's contribution
 - Some taxpayers had attempted to exploit this 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.

Near Misses (what didn't make the Tax Act)

- 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
- Inclusion of inflation in the calculation of the charitable mileage rate
- Repeal of estate and generation-skipping taxes
- Elimination of private activity bonds
- Requirements on art museums seeking to qualify as private operating foundations
- Reporting requirements applicable to the sponsoring organizations of donor-advised funds

Near Misses (or what didn't make the Tax Act)

- 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
- Applicability of UBIT to government pension plans
- Modification to the UBIT exception for fundamental research organizations
- Ability to deduct tuition paid for religious instruction

Questions?

Notice 2017-73 (December 4, 2017)

- Describes approaches being considering on issues involving distributions that may result in benefit to a Donor
 - Bifurcated payments from a DAF and a Donor/Advisor to a charity that provides tickets to an event in return
 - Donations that satisfy a Donor/Advisor's charitable pledge
- Describes changes being considered to the public support test for charities receiving distributions from DAF sponsoring organizations to address concerns of that DAFs are used to circumvent the private foundation rules
- Requests comments on these issues and on use of DAFs by PFs

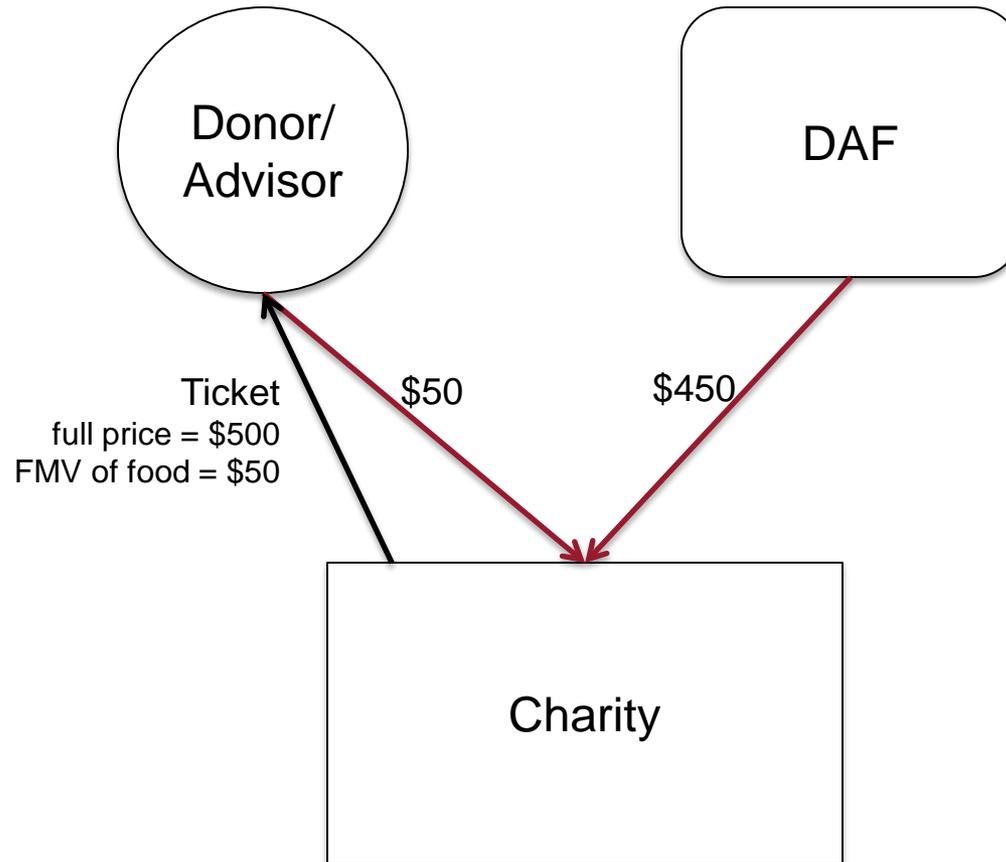
Notice 2017-73 - Concerns

- **“More-than-incidental benefit” to donor – Section 4947**
 - 125% tax is imposed on a donor/advisor who advises a distribution from a fund that results in a “more-than-incidental” benefit to a donor or related party
 - 10% tax on DAF manager agreement to make the distribution, knowing that the distribution would confer such a benefit

- **“Contribution Laundering”**
 - Using DAFs to turn a substantial contributor’s support into public support, and a private foundation into a public charity

- **Avoidance of private foundation payout requirement**

Bifurcated Donations

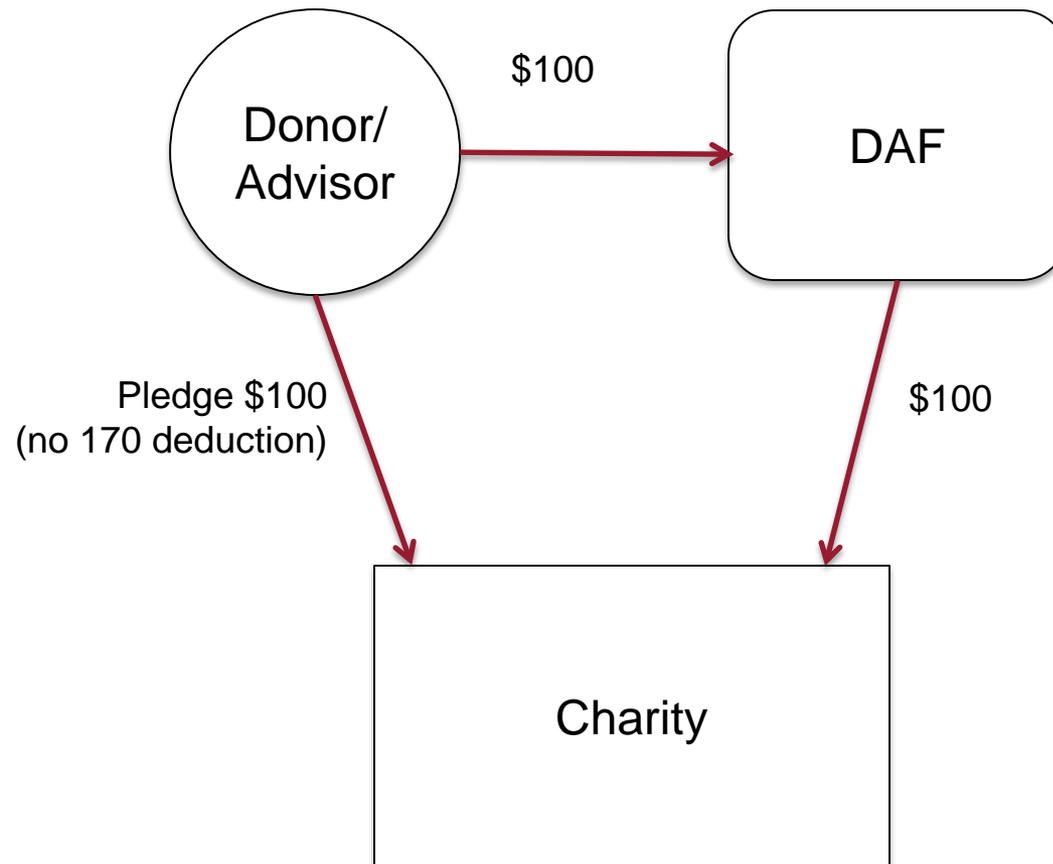


More than an “incidental benefit” to the Donor/Advisor?

Bifurcated Donations (cont'd)

- Notice indicates that DAF payment of *any portion* of the price for a ticket to a charity-sponsored event would be considered a “more-than-incidental” benefit to the Donor, subject to excise tax
- Similarly, a DAF distribution to a charity that pays the deductible portion of a membership fee, enabling the Donor to get the benefits of membership by paying only the deductible portion, would be a “more-than-incidental” benefit to the Donor.

Donor Pledges



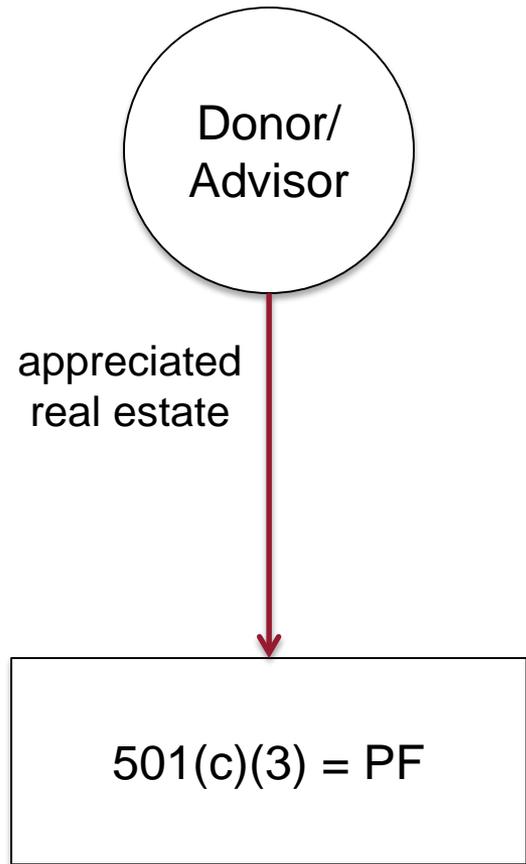
More than an “incidental benefit” to the Donor/Advisor?

Donor Pledges (cont'd)

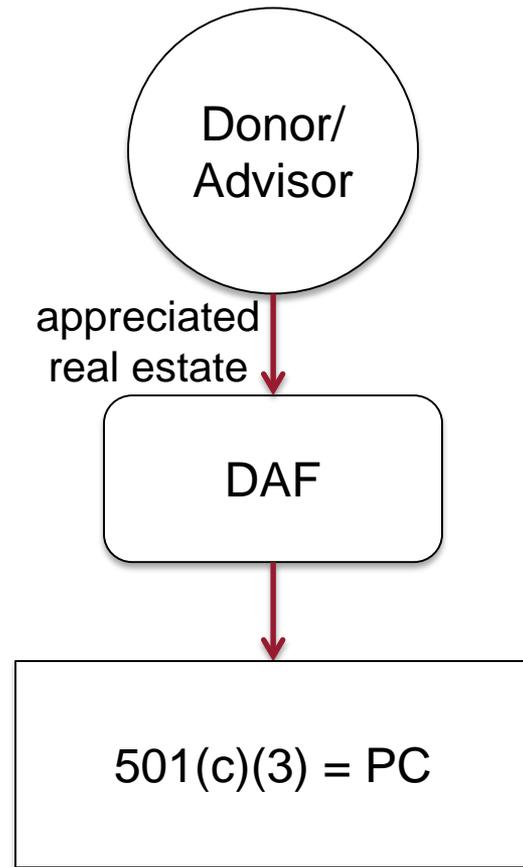
- The Notice indicates that distributions from a DAF to a charity would *not* be considered to result in a more than incidental benefit to a Donor/Advisor merely because the Donor/Advisor has made a charitable pledge to the same charity, if:
 - sponsoring organization makes no reference to the pledge when making the DAF distribution;
 - Donor receives no other benefit, directly or indirectly, that is more than incidental; and
 - Donor does not claim a charitable contribution deduction for the DAF distribution (even if the charity erroneously sends the Donor a written acknowledgment).

- Taxpayers may rely on the Notice now.

Contribution Laundering



- Donor is a “substantial contributor,” and 501(c)(3) is PF with annual distribution requirement
- Donor deduction is basis, 20% of income limit



- 501(c)(3) is public charity because entire DAF contribution is public support – no annual distribution requirement
- Donor deduction is FMV, 30% of income limit

Public Support Calculation Changes

- Notice indicates distributions from a DAF would be considered indirect contributions from a Donor for purposes of the donee charity's public support test, rather than 100% public support from the sponsoring organization.
 - Distributions from a sponsoring organization would be 100% public support only if the sponsoring organization indicates that the distribution was not advised by a Donor from a DAF.
 - Charity must treat all anonymous contributions as being made by one person (including all DAF distributions without identified donors).
- Donee organizations would need more information from a sponsoring organization in order to treat grants as unlimited public support .

Notice Requests Comments by March 5, 2018

- DAF issues addressed in the Notice and suggestions for future DAF guidance;
- How PFs use DAFs and whether transfers by PFs to DAFs should not be “qualifying distributions” unless the sponsoring organization will distribute the funds for charitable purposes (or to its general fund) within a certain timeframe (e.g., 1 year);
- How to implement the proposed changes to the public support test, including what to do about multi-donor accounts and keep the recordkeeping from being unduly burdensome.

Response to Notice 2017- 73 Proposals

- What will be the impact on your organization if the two proposed rules regarding “more-than-incidental benefit” are adopted?
 - Bifurcated payments
 - Donor pledges

- What will be the impact on your organization if the proposed public support test changes are adopted?
 - Additional record-keeping, reporting?
 - Are there other ways to address the IRS concerns that are less burdensome?

Response to Notice 2017- 73 (cont'd)

- What will be the impact on your grantees if the proposed public support test changes are adopted?
 - Is the rule too broad? Does it prevent a lot of good/cause a lot of waste/burden in its effort to address the concerns? Is there a better way?
 - Can your grantees advocate for good rules for themselves? How can you help them?

Response to Notice 2017- 73 (cont'd)

- What will be the impact on your relationship with private foundations in your community if distributions to DAFs will not count as qualifying distributions for private foundations unless they are distributed within a year?
 - Should there be exceptions?
 - Remember exceptions to funds qualifying as DAFs:
 - Funds that make distributions to a single identified organization
 - Scholarship funds advised by a committee not controlled by donor
 - Potential for other exceptions, such as a fund advised by an independent committee or a single-purpose fund

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 - How to implement the proposed changes to the public support test, including what to do about multi-donor accounts and keep the recordkeeping from being unduly burdensome.
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- **INCLUDE COMMENTS ON ISSUES THAT CONCERN YOUR ORGANIZATION AND YOUR COMMUNITY – EVEN IF NOT SPECIFICALLY REQUESTED**

Thank you!