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How nonprofits fare with the 2017 Tax Cuts and Jobs Act

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Like every sector, nonprofits won some and lost some in the Tax Cuts & Jobs Act. Here is a brief summary of the provisions impacting the nonprofit world.

Unrelated business taxable income

Beginning Jan. 1, 2018, organizations carrying out more than one unrelated business activity must separately calculate unrelated business taxable income for each activity. As a result, losses from one trade or business may not be used to offset income derived from another trade or business.

Under prior law, exempt organizations were able to offset unrelated business taxable losses against unrelated business taxable income.

Organizations that provide certain types of qualified fringe benefits, including transportation benefits, qualified parking facilities and use of employer-provided athletic facilities, will be subject to unrelated business income tax on the value of the benefits provided.

Additionally, the use of net operating loss carryover deductions from unrelated business activities are now limited to 80 percent of taxable income and will not be eligible to be carried back (only forward).

New excise tax for large university endowments

An excise tax of 1.4 percent is imposed on the net investment income of endowments at some private colleges and universities with enrollment of more than 500 students and an asset threshold of at least \$500,000 per full-time student.

The new law also makes a slight modification to the definition of "applicable educational institution," which now includes only institutions with more than 50 percent of tuition-paying students located in the United States.

New excise tax on high salaries

A 21 percent excise tax will be imposed on wages in excess of \$1 million for any covered employee of a nonprofit entity. This tax, paid by the organization, is applicable to compensation in excess of \$1 million

for employees of a tax-exempt organization who are among the five highest-paid employees for the taxable year. A special exclusion applies to compensation paid to licensed medical professionals.

The excise tax applies to any "excess parachute payments," which is compensation contingent upon termination of employment where the aggregate present value of the payments exceeds three times the employee's average annual compensation.

This change is intended to bring nonprofit salary taxation in line with tax policy regulating for-profit corporations.

Repeal of advance refunding bonds

Interest on advance refunding bonds (i.e. refunding bonds issued more than 90 days before the redemption of the refunded bonds) will now be taxable. Interest on current refunding bonds continues to be tax-exempt. The provision is effective for advance refunding bonds issued after 2017.

Key observations

The provisions noted above are effective for taxable years beginning after Dec. 31, 2017.

With many variables still unknown regarding how multiple lines of unrelated business activities will be treated, consideration might be given to housing profitable and unprofitable activities in a single taxable corporate subsidiary.

This would enable expenses and income to once again offset, affording the benefit of the lower 21 percent corporate income tax rate. Nonprofits should consult their tax professionals to evaluate the applicability of this and other potential strategies to their individual circumstances.

The adjusted gross income limitation increased to 60 percent (from 50 percent) for cash contributions made to public charities by individuals. Tax-exempt organizations should promote this benefit with donors to increase funding. The provision does retain the five-year carryover rule to the extent the contribution amount exceeds 60 percent of the donor's adjusted gross income.

Boards and committees of tax-exempt organizations need to evaluate conditions for both current and deferred compensation that might result in exceeding the new compensation threshold for the 21 percent excise tax.

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