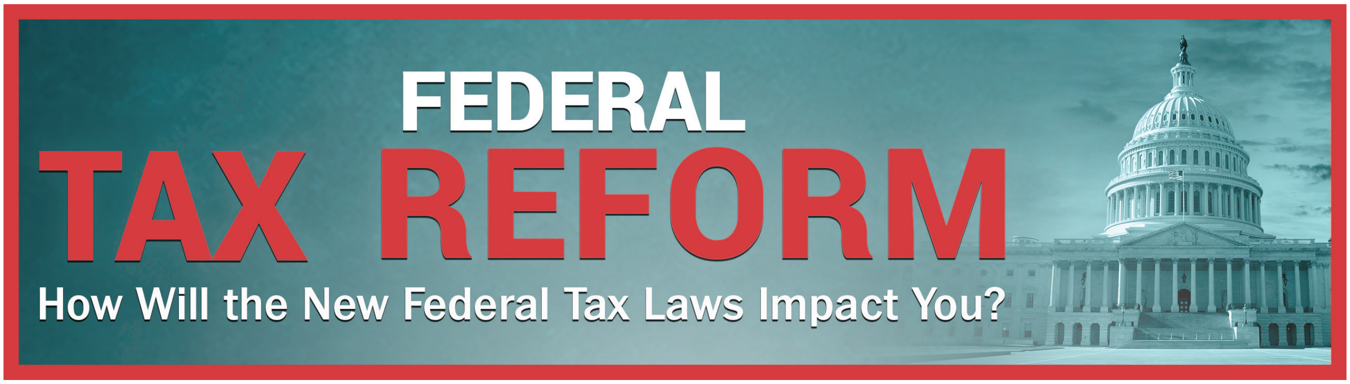
Bowles Rice
ATTORNEYS AT LAW

Important Information from
the Bowles Rice Tax Team



Impacts on Tax-Exempt Organizations

Here's a look at some of the more important elements of the new tax law that have an impact on tax-exempt organizations. In general, the provisions involved are effective starting in 2018.

- **Excise tax on exempt organization's excessive compensation.** Before the new law, executive compensation paid by tax-exempt entities was subject to reasonableness requirements and a prohibition against private inurement. The new law adds an excise tax that is imposed on compensation in excess of $1 million paid by an exempt organization to a "covered" employee. The tax rate is set at 21%, which is the new corporate tax rate. Compensation for these purposes is the sum of (1) remuneration (other than an excess parachute payment) over $1 million paid to a covered employee by a tax-exempt organization for a tax year; plus (2) any excess parachute payment paid by the organization to a covered employee. A covered employee is an employee or former employee of the organization who is one of its five highest compensated employees for the tax year, or was a covered employee of the organization or its predecessor for any preceding tax year beginning after 2016. Remuneration is treated as paid when there is no substantial risk of forfeiture of the rights to the remuneration.

- **Excise tax on private college's investment income.** Before the new law, private colleges and universities were generally treated as public charities, as opposed to private foundations, and were therefore not subject to the private foundation excise tax on their net investment income. The new law imposes an excise tax on the net investment income of colleges and universities meeting specified size and asset requirements. The excise tax rate is 1.4% of the institution's net investment income, and applies only to private colleges and universities with at least 500 students, more than half of whom are in the U.S., and with assets of at least $500,000 per student. For this purpose, assets used directly in carrying out the institution's exempt purpose are not counted. The number of students is based on a daily average of "full-time equivalent" students, i.e., two students carrying half loads would count as a single full-time equivalent student. For purposes of the excise tax, net investment income is the institution's gross investment income minus expenses incurred to produce it, but without the use of accelerated depreciation or percentage depletion.

- **Exempt organization's UBTI computed separately for separate businesses.** Before the new law, a tax-exempt organization computed its unrelated business taxable income (UBTI) by subtracting deductions directly connected with the unrelated trade or business from its gross income from the unrelated trade or business. If the organization had more than one unrelated trade or business, the organization combined its income and deductions from all of the trades or businesses. Under that approach, a loss from one trade or business could offset income from another unrelated trade or business, thus reducing overall UBTI. Under the new law, an exempt organization cannot use losses from one unrelated trade or business to offset income from another one. Gains and losses are calculated and applied to each unrelated trade or business separately. There is an exception for net operating losses from pre-2018 tax years that are carried forward.

- **Exempt organization's UBTI to include disallowed fringe benefit costs.** Under the new law, an exempt organization's unrelated business taxable income (UBTI) is to include any nondeductible entertainment expenses, and costs incurred for any qualified transportation fringe, parking facility used in connection with qualified parking, or any on-premises athletic facility. However, UBTI is not to include any such amount to the extent it is directly connected with an unrelated trade or business regularly carried on by the organization.

Questions?

If you wish to discuss any of these provisions, please contact a member of the Bowles Rice Tax Team.

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