LOEB & LOEB LLP

Nonprofits and Tax-Exempt Organizations

ALERT

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Tax Reform Part 2: Senate Bill Provisions That Would Impact Exempt Organizations

The Senate Finance Committee has released a description of the chair's mark of the Tax Cut and Jobs Act, as prepared by the Joint Committee on Taxation. The full text of the Senate bill will be released after the committee's markup, which will commence November 14. The House and Senate bills differ significantly including on several legislative proposals regarding tax-exempt organizations. If both the House and Senate enact their respective bills, a conference committee will be appointed to reconcile the differences. Both chambers will then vote again on the conference bill.

We previously summarized the House proposals affecting exempt organizations. In this alert, we highlight the key differences between the House bill and Senate bill (as of the Senate Finance Committee's November 9 description) from the perspective of exempt organizations. For a broader discussion of the tax reform proposals, please see our tax alerts on the House bill and the Senate bill.

New Proposals Affecting Exempt Organizations in the Senate Bill:

- **Modification of Taxes on Excess Benefit Transactions.** The Senate bill includes significant proposed modifications to the excise tax provisions that penalize excess benefit transactions, known as the "intermediate sanctions" rules, set forth in Internal Revenue Code § 4958. Specifically, the Senate bill proposes to:
  - Extend application of the intermediate sanctions rules to trade associations exempt under IRC § 501(c)(6) and labor unions exempt under IRC § 501(c)(5).
  - Expand the definition of "disqualified persons" to include investment advisors and athletic coaches.
  - Impose an entity-level tax equal to 10 percent of the excess benefit unless the organization can show that its participation is not willful and is due to reasonable cause. This tax will be distinct from the existing taxes assessed on disqualified persons and organization managers. To avoid this tax, the organization must establish that minimum standards of due diligence were met.
  - Eliminate the "rebuttable presumption" of reasonableness for transactions with disqualified persons. The current three-pronged rebuttable presumption procedures could be used to demonstrate compliance with minimum due diligence procedures under the new proposal. Compliance with these procedures would enable a disqualified person to avoid penalty taxes, but would not alleviate managers' tax liability for officers or directors who approve an excess benefit transaction.
  - Eliminate safe harbors for board members and officers that are currently based on either

the rebuttable presumption or reliance on professional advice (e.g., compensation consultants). Under the Senate proposal, reliance on professional advice would remain a relevant consideration in determining whether a manager knowingly participated in an excess benefit transaction.

- **Unrelated Business Income Tax (UBIT)**
  - **Tax on Royalty Income.** The Senate version would amend IRC § 513 to provide that any sale or licensing by an exempt organization of its name or logo (including any trademark or copyright related to a name or logo) is an unrelated business that is regularly carried on, and subject to the UBIT rules. IRC § 512 would also be amended to eliminate the present exclusion from UBIT for passive royalty revenues. If this proposal is enacted, any income from the sale or licensing of an EO's name or logo would be included in the organization's gross unrelated business taxable income (UBTI).
  - **UBTI Computed Separately for Each Trade or Business.** The Senate bill proposes a requirement that UBTI first be computed separately with respect to each trade or business, and without regard to the deduction generally allowed under IRC § 512(b)(12). A net operating loss deduction would be allowed only with respect to the trade or business from which the loss arose. An exempt organization would not be able to use net operating loss deductions from one unrelated trade or business to offset income from another one.
- **Professional Sports Leagues.** The Senate Bill repeals the tax-exempt status under IRC § 501(c)(6) for professional football leagues, and provides that no professional sports leagues, including those administering pension funds for players, will be exempt under IRC § 501(c)(6).

Common Proposals in Both the Senate and House Bills:

- **Executive Compensation.** The Senate bill retains the proposed 20 percent excise tax (new IRC § 4960) on executive compensation over $1 million paid by EOs to any of their top five highest-paid employees. If this proposal and the Senate bill's proposed modifications to the intermediate sanctions rules become law, governing boards of some EOs may find it challenging to reconcile the results of the comparability analysis mandated by IRC § 4958 with the $1 million limit on compensation imposed by IRC § 4960.
- **Private College and University Endowment Tax.** The Senate bill retains the House proposal to impose a 1.4 percent excise tax on net investment income (endowment earnings) of private colleges and universities that have at least 500 students and assets (other than those used directly in carrying out the institution's educational purposes) valued at the close of the preceding tax year of at least $250,000 per full-time student.

Key House Proposals Omitted From the Senate Bill:

- **Private Foundation Excise Taxes.** The Senate bill omits the House proposal to streamline the excise tax on net investment income imposed under IRC § 4940 with a single rate of 1.4 percent. It also omits the proposed modification to the "excess business holdings" rules of IRC § 4943 to permit foundations to own and control certain philanthropic for-profit businesses if certain governance/control conditions are met.
- **Tax-Exempt Bonds.** Unlike the House bill, the Senate bill would not eliminate IRC §145, which provides for "qualified 501(c)(3) bonds." The Senate bill preserves the interest-free financing mechanism on which colleges and universities, hospitals, and other 501(c)(3) organizations rely to fund construction, renovations and capital improvements.

- **Johnson Amendment.** The Senate bill omits the House proposal to repeal the Johnson amendment, preserving the prohibition against political campaign intervention.
- **Donor Advised Funds (DAFs).** The Senate bill does not include the heightened reporting requirements for DAF sponsoring organizations regarding aggregate funds, payout and spending policies.

If you have any questions about how the tax reform proposals would affect your exempt organization or its officers, directors, employees or donors, please do not hesitate to call a member of our Nonprofits and Tax-Exempt Organizations practice group.

Loeb & Loeb LLP's Nonprofits and Exempt Organizations Practice

Loeb & Loeb's leading national Nonprofits and Tax-Exempt Organizations Practice offers the full spectrum of services to help nonprofit organizations grow, innovate and succeed in the face of increasing regulatory and marketplace challenges. Our distinguished practice team includes some of the nation's leading nonprofit legal authorities, including former top regulators at the federal and state levels, offering unique insight and regulatory perspective that do not exist elsewhere.

The nonprofit legal landscape is challenging for even the most sophisticated organizations. Our experienced lawyers offer skilled guidance on what tax-exempt entities need to know to stay compliant with both federal and state legal requirements. Our core nonprofit practitioners work closely with the firm's other leading practices — corporate, trusts and estates, litigation, intellectual property, advertising and promotions, real estate, digital media and technology, executive compensation, and employment law — to provide our clients with a truly integrated platform at an exceptional value.

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