Senate and House Bills differ substantially on provisions for tax-exempt organizations

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The Senate and House of Representatives have now each passed a separate version of the Tax Cuts and Jobs Act that will need to be reconciled and approved before being sent to President Trump's desk to be signed into law. There are fewer provisions in the Senate Bill than the House Bill pertaining to tax-exempt organizations (the authors have separately summarized the relevant provisions of the House Bill); however the provisions in the Senate Bill are significant and some differ substantially from those of the House Bill. Below is a comparison of the relevant House and Senate provisions.

60% AGI limit on cash contributions—Senate and House provisions

Under current law, the deduction for charitable contributions by individuals is limited to a specified percentage of a donor's adjusted gross income, which varies based on the type of property contributed and the status of the recipient organization. Both bills would enact a provision allowing individuals to make cash contributions to charity up to 60% of their adjusted gross income for gifts of cash to public charities, including donor advised funds and private operating foundations. As under current law, any excess contributions over the 60% limit can be carried forward and deducted in each of five succeeding years.

Deduction relating to amounts paid for right to purchase tickets—Senate and House provisions

Both bills would repeal the current rule allowing a charitable deduction for 80% of amounts paid for the right to purchase tickets to college athletic events.

Charitable deductions from ESBT income—Senate Bill only

The Senate Bill contains a provision not in the House Bill which addresses charitable deductions by electing small business trusts (“ ESBTs”). The provision expressly makes the normal trust charitable deduction provision (Section 642 (c)), which generally allows nongrantor trusts an unlimited deduction in most circumstances, inapplicable to S Corporation income earned by an ESBT. The provision in the Senate Bill instead provides ESBTs a charitable deduction based on the rules generally applicable to individuals (Section 170), effectively subjecting all ESBTs to the percentage limitations and other restrictions relevant to individuals.

Penalty tax on excessive compensation paid by non-profits—Senate Bill only

The Senate Bill would install a new penalty tax provision with respect to excessive compensation paid to highly-paid employees of non-profit organizations, including all 501(c)(3) organizations. The tax applies to employees who are among the group of five employees who are the organization's most highly paid. An aggregation rule applies for employees who work for related organizations to avoid structural methods of circumventing the penalty tax. The tax is payable by the employer and is equal to 20% multiplied by the excess of compensation over US$1,000,000 plus excess parachute payments. There is no corresponding provision in the House Bill.

The Harvard tax—Senate and House provisions

Like the House Bill, the Senate Bill would create a new excise tax on the investment income of colleges and universities equal to 1.4 percent of the institution's net investment income. The House Bill would tax colleges and universities whose endowments exceed US$500,000 per student. The Senate Bill would likewise tax institutions whose endowments are in excess of US$500,000 per student. Interest groups have estimated that this tax will only apply to about 30 institutions nationwide.

Private foundation excise tax—House Bill only

The House Bill changes the excise tax on the investment income of private foundations from the two-tiered 2 percent/1 percent tax under current law to a blended 1.4 percent rate on investment income. This new rate of tax would apply to all foundations regardless of the size of their endowments. The Senate Bill has no provision regarding taxation of foundation investment income.

Rules relating to UBIT—Senate and House provisions

With respect to the tax on unrelated business income, the Senate Bill provides a statutory rule that unrelated trades or business of charities are treated separately for purposes of determining taxable income and loss. Effectively, this ensures that each activity of a charity is place into a separate basket so that gains of one activity cannot be offset by losses of another activity. The House Bill does not contain such a provision.

The House Bill would make two changes to the unrelated business income tax. First, it would clarify that all entities treated as exempt under Section 501(a) are subject to the unrelated business income tax. This provision is particularly notable for government pension plans, some of which take the position that the tax does not apply to them due to their status under Section 115(l). Second, the House Bill would clarify that the exclusion from the unrelated business income tax for income derived in connection with a research trade or business applies only where the results of the research in question are made freely available to the public. The Senate bill does not contain a corresponding provision.

Private art museums—House Bill only

The House Bill would require art museums claiming status as private operating foundations to be open to the public for at least 1,000 hours annually. This provision is likely an outgrowth of an inquiry last year by the Senate Finance Committee, which expressed concern that some private art museums were not providing sufficient public benefit to merit the preferential tax treatment afforded to their donors. Other types of private operating foundations utilized by art collectors, including those which carry out programs involving the lending of art, would not be directly affected by the new rules. The Senate Bill does not contain a corresponding provision.

Newman's Own exception—House Bill only

Newman's Own Inc., the popular food manufacturer that has donated all of its after-tax profits to charity since its founding in 1982, was transferred to Newman's Own Foundation after Paul Newman's death in 2008. As a private foundation, the Newman's Own Foundation is subject to the "excess business holdings" rule, which limits the stake it can hold in a for-profit business under penalty of a 200% excise tax. After nearly a decade of aggressive lobbying by Newman's Own Foundation, the tax reform bill would amend the excess business holdings rule to provide a special exception where four criteria are met: (i) a foundation owns all of a for-profit business' voting stock, (ii) the foundation did not acquire its interests by purchase, (iii) the for-profit business distributes its net operating income to the foundation within 120 days of the close of its tax year, and (iv) the for-profit business' directors and executives are not foundation insiders. There is no corresponding provision in the Senate Bill.

Political statements by religious organizations—House Bill only

The House Bill would qualify the so-called "Johnson Amendment," which prohibits charitable organizations from "participating in, or intervening in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office," to allow 501(c)(3) organizations to make political statements in the ordinary course of business so long as any associated expenditures are de minimus. A last-minute amendment to the provision would sunset the allowance (once again prohibiting charities from making political statements) just in time for the commencement of the 2024 presidential election cycle. There is no corresponding provision in the Senate Bill.

Increased reporting by donor advised funds —House Bill only

Unlike private foundations, which are required to make annual donations of 5% of their non-charitable use assets, donor advised funds are not currently required to make annual distributions. The House Bill continues this rule, but would require organizations maintaining donor advised funds to report the average value of grants made each year as a portion of their endowments and to report whether they have a policy in place regarding the frequency and minimum level of distribution required with respect to donor advised accounts. There is no corresponding provision in the Senate Bill.

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