Memo

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TO: Endowment Professionals, State Government Affairs Directors, Community Relations Council Directors and Interested Parties

FROM: William C. Daroff
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RE: Comprehensive Tax Reform: Impact on Federations

House Releases Comprehensive Tax Reform Plan

The House leadership comprehensive tax reform bill, H.R. 1, "the Tax Cuts & Jobs Act," was released yesterday. (Bill text; section-by-section summary) The House Ways & Means Committee has already announced that it will begin "marking up" the bill on Monday, November 6. House leadership hopes for a full House vote on the bill will occur before the Thanksgiving holiday. The Senate Finance Committee anticipated beginning work on its version of comprehensive tax reform during the week of November 13. The goal of both the Republican leadership and the White House is to deliver a final package to the President for signature before the end of the calendar year.

While we can expect to see some changes to the bill as the House Ways & Means Committee works on the bill next week, following is a quick summary of and some observations regarding some of the most important provisions that will impact federations. Much of the tax bill impacts corporate and international taxation and while JFNA does not plan to take a position for or against the entire package, we will continue to speak out regarding charitable giving incentives and other tax provisions that impact the Federation system. Advocacy recommendations are included in the summary below.

Perhaps most importantly, from a fundraising perspective, if the tax bill becomes law before the end of the year, it presents tax planning opportunities for our donors because as a general rule, the value of charitable contributions for many will be greater in 2017 than in 2018. Regardless of ultimate passage, Federations should consider contacting donors to discuss whether to discuss their philanthropic plans.

Charitable Giving and Other Incentives/Changes

Charitable Contributions (Bill Section 1306, p. 110): The bill preserves the existing charitable contribution deduction as one of only three remaining itemized deductions. Both of the other two itemized deductions will be limited in scope (interest on a home mortgage up to $500,000 and a $10,000 cap on real property taxes). The limitations, in addition to the nearly doubling of the standard deduction would dramatically decrease the number of taxpayers who itemize (and thus claim the charitable contribution deduction) from approximately 30 percent currently to 5 percent. Because fewer taxpayers would itemize and benefit from the tax incentive for charitable contributions, overall giving would be expected to decrease. One positive change in the bill would increase the current adjusted gross income limit for current deductible charitable contributions of cash to ***60 percent*** from the current 50 percent. Another positive change is the repeal of the so-called “Pease amendment” that currently limits otherwise allowable itemized deductions for certain upper-income taxpayers (those with incomes in excess of $313,800).

> **Observation:** A recent study from Indiana University estimates that the decrease in number of itemizers could cause total charitable giving to drop by $13 billion annually. This has led many national charities to push for an “above-the-line” or so-called “nonitemizer” charitable contribution deduction. While H.R. 1 does not include such relief, major national charities will be pushing for an amendment to include such a provision next week. JFNA will continue to be a lead organization in this advocacy effort.

Tax Rates: (Bill Section 1001, p. 6): The bill consolidates and simplifies the current tax rate structure **but retains** a top tax rate of 39.6 percent. However, the new rate will only apply to taxable income in excess of $1 million (currently applies at $470,700 for married couples.) Some taxpayers will benefit from lower tax rates; this, in turn, will increase their “after-tax cost of charitable giving.”

> **Observation:** The new tax rates, as well as most other provisions in the overall bill, would be effective for tax years beginning after 2017. There had been some speculation that the tax bill would be retroactive to the beginning of this calendar year. ***If tax rates will fall and the value of charitable contributions will be greater this year, donors should be encouraged to consider accelerating or increasing charitable contributions before December 31, 2017. Federations should contact donors to discuss their individual situation.***

Estate Tax (Bill Section 1601-1602, p. 168**):** The bill would double the current ($5.6 million) exemption for the federal estate tax and repeal the tax (and the generation-skipping transfer tax) after 2023, while maintaining a beneficiary’s stepped-up basis in estate property. Doubling the exemption excludes from coverage estates of individuals valued at less than about $12 million and about $24 million for couples’ estates.

> **Observation:** The bill also provides that the gift tax shall remain after 2023 with a top rate of 35 percent. A lifetime gift tax exemption that is similar to the estate tax exemption will also apply.

Donor Advised Funds (Bill Section 5202. P. 428): The bill imposed an additional reporting requirement on donor advised fund sponsoring organizations. They would be required to disclose the aggregate average amount of grants made as well as whether they maintain an inactive fund policy (and attach such policy with their annual Form 990).

> **Observation:** This disclosure requirement is an attempt to respond to criticism that donor advised funds “warehouse” donor contributions but is not as penal as prior proposals to impose an annual distribution requirement (either at the aggregate or

individual account level) on donor advised funds. JFNA will continue to forcefully advocate for the value of donor advised funds as important planned giving vehicle and oppose any additional provisions in tax legislation that would hamper their operation.

Private School Tuition (Bill Section 1202, p. 91): The bill expands so-called "Section 529 savings plans" or qualified higher education tuition plans to include the payment of ***up to $10,000*** of tuition expenses for elementary or secondary school students at public, private or religious schools.

Observation: Although the bill would repeal the current "Coverdell education savings accounts" that permit limited tax-free accounts for primary and secondary education, amounts in such accounts could be rolled-over tax free into new or existing Section 529 plans. This expansion of Section 529 plans would provide an opportunity for some to save tax-free for "day school costs." Although contributions are not deductible, earnings in a 529 plan grow tax-free and are not subject to tax when the funds are withdrawn for qualified tuition expenses. JFNA will vigorously support this and other federal tax incentives for private school education.

Private Activity Bonds (Bill section 3601, p. 271): The bill provides that interest on newly issued private activity bonds would be included in income for bonds issued after 2017.

Observation: This would effectively eliminate the tax-exempt financing alternative that some Federations have used to reduce their cost of capital in major building projects through the National Jewish Federation Bond Program. JFNA will work with other impacted issuers including colleges and universities to actively oppose this provision.

Tax Credit for Access for Disabled (Bill section 3407, p. 255): The bill repeals the current tax credit for expenditures by small businesses (those with no more than $1 million in gross receipts or those that employ 30 full-time employees or less) on architectural and other barriers to provide access for individuals with disabilities. JFNA will actively oppose the repeal of this provision.

Other Provisions impacting Charities

Political Activities by Charities (Bill Section 5201, p. 427): The bill includes language that would significantly weaken the Johnson Amendment, the tax-law prohibition of charities, including houses of worship from endorsing or opposing candidates for public office. As written, the new provision grants a partial exemption organizations organized and operated exclusively for religious purposes, assuming the "speech" is in the ordinary course of the organization's business and its expenses incurred are "de minimus."

Observation: Although this represents only a "limited repeal" of the Johnson Amendment, JFNA will join with the overwhelming majority of charities, including religious groups, opposing this change that would weaken the fabric of this important protection from partisan politics that has enabled charities and houses of worship to remain focused on their mission.

Certain Tax-free Fringe Benefits and Unrelated Business Income Taxes (Bill section 3308, p. 243): Under the bill, tax-exempt entities would be taxed on the values of providing their employees with transportation fringe benefits, certain parking facilities and on premise gyms, by treating the funds used to pay for such benefits as unrelated taxable income. This will put tax-exempt entities on par with for-profit businesses that will lose the tax deduction for providing such benefits to employees.

Medical Expense Deduction (Bill section 1308, p. 113): The bill repeals the itemized deduction for medical expenses.

Excise Tax on Excess Compensation (Bill section 3803, p. 306): The bill will subject a tax-exempt organization to a 20 percent excise tax on compensation in excess of $1 million per year paid to any of its five highest paid employees. The excise tax would not apply to payments to a tax-qualified retirement plan.

Excise Tax on College Endowments: (Bill section 5103, p. 422) The bill would impose a 1.4 percent excise tax on net investment income of private colleges and universities with assets (not counting those used directly in carrying out the institution's educational purposes) valued at the close of the preceding tax year of at least $100,000 per full-time student.

Observation: Although this provision is only applicable to private colleges (not state colleges and universities or other charities with large endowments), it does reflect a general "anti-endowed giving" sentiment among some Congressional members and staff. JFNA will continue to speak out forcefully regarding the importance of planned giving and endowment vehicles for the future vitality of the philanthropic sector.

Timing and Prospects for Passage

As noted above, the House Ways and Means Committee is scheduled to start its review of the on Monday, November 6, and continue with marathon sessions until completing action during the week. The bill is then expected to go to the House floor the week of November 13. The Senate is expected to release its separate version in mid-November. Most observers believe that a comprehensive tax reform bill will pass the full House (although a number of Republican members from states where state and local taxes are significant have already signaled the need for additional compromise on this issue and some conservative members object that the bill does not reign in deficit spending). The real political battle is expected to occur in the Senate where several key Republicans have voiced overall and specific objections to tax reform outlines. Although the stated goal of Republican leaders is to have a bill on the President's desk by New Year's Day, this will continue to be a heavy lift over the limited number of legislative days remaining in the calendar year.