



Tax Cuts and Jobs Act: How Private Foundations Could Be Affected

The new proposed “Tax Cuts and Jobs Act” (H.R. 1) (the “Act”) could have a significant impact on private operating and grant-making foundations. Should the bill become law, there are likely to be significant changes made to it, and we will keep you apprised of those as developments unfold.

Below is a brief summary of the provisions of the Act most directly affecting private foundations:

- **Revised Excise Tax on Private Foundation Net Investment Income:** The Act would reduce the 2% excise tax on net investment income to 1.4%, but would also eliminate the current ability of foundations to qualify for a lower rate of 1%.
- **Expanded Requirements for Private Foundations Operating Art Museums:** An art museum that reports as a private operating foundation would have to ensure that it is open to the public for at least 1,000 hours per year to avoid the five percent minimum payout requirement applicable to private non-operating foundations.
- **Exemption of Certain Independent Business Holdings from Private Foundation Excess Business Holdings Rules:** Private foundations are generally forbidden from holding significant interests in active, for-profit businesses. The Act would create an exception for certain wholly-owned business subsidiaries of private foundations that are not acquired by purchase, are governed independently from their parent foundations, and distribute all of their net operating income each year to their parent foundations.
 - Only private foundations – and not donor-advised funds, supporting organizations, nonexempt charitable trusts, or split-interest trusts that are similarly subject to the excess business holdings rules – could take advantage of this limited exception.
- **Expansion of Unrelated Business Income Tax to Certain Research Income:** The bill would expand taxation of income from research of certain tax-exempt organization, including private foundations, that do not make all of their research available to the general public.
- **Increased Taxation of Tax-Exempt Organizations for Certain Fringe Expenses for Employees:** The value of certain fringe benefits to employees of tax-exempt organizations (including private foundations), such as certain transportation and





parking benefits and use of on-premises athletic facilities, would be treated as unrelated business taxable income and subject to tax.

- This rule would apply to expenses that would not be deductible by for-profit corporations under Section 264 of the Code, and is intended to put for-profit and tax-exempt organizations on equal footing by requiring tax-exempt organizations to pay a tax (equal to the effect of a deduction denied to for-profit organizations) whenever they provide such benefits.
- Because the Act separately would limit the ability of for-profit companies to deduct certain fringe benefits that historically may have been deductible (in particular certain entertainment, amusement, and recreation expenses), private foundations would need to review their fringe benefits carefully to ensure that they can substantiate the extent to which such benefits would be deductible under the newer, more restrictive rules of Section 264 of the Code.
- **Limitation on Income Exclusion for Employer-Provided Housing:** Employees of private foundations would be required to treat as taxable income the value of any housing provided in excess of \$50,000 (\$25,000 for married individuals filing separately). The excludable amount would phase out for highly compensated individuals.
- **Elimination of Employer-Provided Child Care Credit:** Like all employers, private foundations would no longer be able to take a credit for child care services provided to employees.
- **Elimination of Work Opportunity Tax Credit:** Private foundations and other employers would no longer receive tax credits for hiring individuals from groups that have consistently faced significant barriers to employment, including veterans.
- **Consolidation of Certain Non-Qualified Deferred Compensation Rules:** The Act would consolidate the rules applicable to certain nonqualified deferred compensation plans, including some plans offered by tax-exempt organizations, under new Section 409B. Compensation from 409B plans would be included in an employee's gross income in the first taxable year in which there is no substantial risk of forfeiture.
- **Elimination of Income Exclusion for Private Activity Bonds and Elimination of Credits for Tax Credit Bonds:** The Act would eliminate the exclusion from income derived from any private activity bond, whether or not the bond would otherwise have qualified as an exempt facility bond, qualified small issue bond, qualified student loan bond, qualified redevelopment bond, or qualified





501(c)(3) bond under current rules. It would also eliminate tax preferences for renewable energy bonds, energy conservation bonds, forestry conservation bonds, zone academy bonds, school construction bonds, and Build America Bonds.

- **Elimination of Certain Community Development and Rehabilitation Tax Credits:** The Act would eliminate the New Market Tax Credit, as well as the historic rehabilitation tax credit.
- **Mileage Rates for Charitable Automobile Use:** The Act would replace the current standard mileage rate of 14 cents per mile for charitable use of an automobile with a more flexible permitted rate.
- **Changes to Personal Income Tax Rates and Deductions:**
 - Many donors would receive less of a tax benefit from charitable contributions due to decreased incentives to itemize deductions.
 - While the Act would increase the 50% limitation for cash contributions to public charities to 60%, the current rates of 30% (for cash contributions) and 20% (for certain appreciated property) applicable to private foundations would remain unchanged.
- **Estate and GST Tax Repeal:** The Act would essentially double the current estate tax exemption amount starting in 2018, and would repeal the estate and GST taxes entirely by 2024.
 - Repeal would eliminate the estate tax incentives for legacy gifts. However, donors would still have strong incentives to make legacy gifts from certain retirement plans or other assets that would be subject to income tax upon or after death.

Hemenway & Barnes will continue to monitor the Tax Cuts and Jobs Act and its potential effect on its private foundation clients.

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