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TaxNewsFlash

Exempt Organizations

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Highlights of 2019 appropriations legislation affecting tax-exempt organizations

President Trump on December 20, 2019, signed into law H.R. 1865 ("The Further Consolidated Appropriations Act, 2020," Pub. L. No. 116-94)—a government funding bill that includes significant tax provisions of interest to tax-exempt organizations.

This report provides information and observations regarding implications of these provisions for certain tax-exempt organizations.

Repeal of the "parking tax"

Most notably, the legislation repeals what is commonly referred to as the "parking tax"—that is the tax imposed under section 512(a)(7), which required tax-exempt organizations to include in unrelated business taxable income the amounts they paid or incurred on qualified transportation fringe benefits. Section 512(a)(7) was enacted as part of the 2017 U.S. tax law (Pub. L. No. 115-97)—the law that is often referred to as the "Tax Cuts and Jobs Act" (TCJA).

The repeal takes effect retroactively to the date of enactment of the TCJA—that is, December 22, 2017.

The Joint Committee on Taxation (JCT) estimated that this provision would lose approximately $1.87 billion over a 10-year period.

KPMG observation

Because the repeal of section 512(a)(7) is retroactive back to the December 22, 2017 date of enactment, organizations that paid unrelated business income tax (UBIT) on their employees' qualified transportation fringe benefits will presumably be entitled to a refund of all such UBIT.

Modified rate for tax on foundation investment income

The December 2019 legislation changed the long-standing two-tiered excise tax rate applicable to investment income of certain private foundations—under section 4940(a)—to a single 1.39% rate. This provision applies to tax years beginning after the date of enactment of the 2019 legislation (i.e., beginning after December 20, 2019).

The JCT estimated that this provision would have negligible revenue effect over a 10-year period.

KPMG observation

Changing the private foundation excise tax from a two-tier rate to a flat 1.39% tax is expected to increase the excise tax paid by some private foundations and to decrease the amount paid by others. However, the administrative burden of calculating the tax may be reduced for all private foundations.

Cooperative telephone and electric companies

The legislation modified the rules for determining the tax-exempt status of certain mutual or cooperative telephone or electric companies. The provision generally allows mutual or cooperative telephone or electric companies to exclude from income certain government grants when applying the requirement under section 501(c)(12)—that is, 85% or more of their income must consist of amounts collected from members. The provision is effective retroactive to tax years beginning after December 31, 2017.

KPMG observation

The TCJA amended Code section 118 to provide that contributions after December 22, 2017 "by any governmental entity or civic group" that was not a shareholder could no longer be excluded from income as a contribution to capital. This caused section 501(c)(12) cooperatives to be concerned that government grants would have to be recognized as non-member income, thereby jeopardizing their tax-exempt status. Although the new provision is retroactive to tax years beginning after December 31, 2017, it appears that questions remain regarding whether government grants made after December 22, 2017, and before the first day of a cooperative's first tax year beginning after December 31, 2017, could still adversely affect the cooperative's tax-exempt status under section 501(c)(12).

Temporarily increased limits on disaster relief contributions

The December 2019 legislation permits taxpayers that make certain "qualified contributions" for disaster relief to deduct up to 100% of their adjusted gross income (if individuals) or taxable income (if corporations). For these purposes, a "qualified contribution" is a charitable contribution: (1) paid, during the period beginning on January 1, 2018, and ending 60 days from the date of enactment or February 18, 2020; (2) made for relief efforts in one or more qualified disaster areas; (3) for which the taxpayer has obtained a contemporaneous written acknowledgment that such contribution was used (or is to be used) for relief efforts as described above in (2); and (4) for which the taxpayer has elected the application of the increased limitation with respect to the contribution (an election that must be made separately by each partner or shareholder in the case of a contribution made by a partnership or S corporation). Contributions made to a supporting organization described in section 509(a)(3) or to establish or maintain a donor advised fund are not "qualifying contributions"

The JCT estimated that this change would lose approximately $1 billion over a 10-year period.

KPMG observation

The provision temporarily lifts the percentage of income limitations ordinarily imposed on the charitable contributions of individuals (up to 60% of adjusted gross income, for cash contributions to public charities) and corporations (generally 10% of taxable income) for qualified contributions for disaster relief. The window that donors have to make new charitable contributions that qualify for the increased percentage of income limitation is short, as the provision only applies to qualified contributions made through February 18, 2020. The provision also applies to qualified contribution that have already been made, going back to January 1, 2018.

Fix to the "kiddie tax"

The December 2019 legislation modified the taxation of unearned income of certain children (the "kiddie tax"). The provision repeals section 1(j)(4), a paragraph added by the TCJA that subjected the net unearned income of children to the tax rate schedule applicable to trusts and estates. With the repeal, a child's net unearned income will once again be taxed at the higher of the child or parents' rates on net unearned income.

This change is generally effective for tax years beginning after December 31, 2019. However a taxpayer may elect for the change to apply retroactively to tax years beginning in 2018 or 2019.

The JCT estimated that this change would lose approximately $470 million over a 10-year period.

KPMG observation

The repeal of section 1(j)(4) addresses concerns that the provision was affecting a broader segment of taxpayers than had been anticipated when the TCJA was enacted—such as certain scholarship recipients and surviving children of deceased military members (i.e. "Gold Star" families) and surviving children of certain first responders. The kiddie tax change caused many children whose parents had moderate or lower incomes to pay tax at much higher rates because the trust tax brackets are much narrower than the individual income tax brackets, with the highest tax bracket of 37% applicable to all income over $12,700 in 2018 (as compared to $480,050 for an individual married filing jointly).

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