WHAT THE EXEMPT ORGANIZATIONS COMMUNITY <u>MUST KNOW</u> ABOUT THE NEW TAX LAW
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On the three month anniversary of the enactment of the new tax law (originally titled "Tax Cut and Jobs Act," but enacted as "[21 words that reflect absence of simplification]"), I must note with alarm that the exempt organizations sector has yet to speak up and address the HUGE impact and resource-drain this law imposes upon the sector.

While the IRS' Statistics of Information (SOI) numbers reflect that 501(c)-exempt organizations overall filed 34,229 Forms 990-T in 2013,[1] **that number (and the amount of tax due thereupon)** is about to explode given two of the four major changes the law imposes on tax-exempt organizations:

> (1) the requirement to report UBIT on an activity-by-activity basis, with loss in any one activity not available to apply against other activities' gains (i.e., mandating reporting by "silo" of UBIT activity under new Code section 512(a)(6)); and
> (2) the application of what is potentially one of the worst "tax laws" ever enacted – the "if you provide mass transit OR parking as a "Code section 132 nontaxable benefit to your employees," you must treat the <u>expenses</u> you paid or incurred toward such benefits as <u>taxable to you</u> via reporting them (as taxable income) on a Form 990-T, a need that applies to costs incurred NOW in 2018 regardless of the filer's actual tax year (this via enactment of new Code section 512(a)(7)).

Not only will these provisions increase the number of Form 990-T filings [per (2), aboe], but they will most assuredly result in higher bottom-line UBTI being calculated upon organization's existing unrelated activities, i.e., those which are "profitable" (which in most cases reflects the organization's application of excess capacity, arguably a result that is akin to "investment," but is still subjected to the UBIT scheme in its attempt to "level the playing field" with taxable entities). Of course, having exempt organizations pay increased amounts of UBIT-tax is the goal of (1), above (given legislators' needs to score some tax revenues in a bill that overall provides tax decreases).

Unfortunately, it has YET TO BE sufficiently appreciated by the overall sector that the bill imposes an effective *tax rate increase* <u>of 40%</u> for all filers with bottom-line <u>UBTI of <$50,000</u> (prior to the new law, that bracket was taxed at a 15% rate and now of course will be subject to a 21% rate). For filers of the 990-T who had UBTI within the prior law's next bracket (that reaching UBTI of $50,000 - <$74,999), their *total blended tax rate* will be increased no less than 3.3% (at the top of the bracket) and upwards to 39.99% (at the bottom of the bracket).

This news is <u>depressing</u> on multiple fronts as spokespeople for the sector and individual sub-sectors within have yet to appreciate the gravity of harm here:

> (a) additional costs to calculate and remit quarterly estimates;
> (b) additional costs for Form 990 preparation (particularly true for those who had no Form 990-T filing requirement until enactment of new 512(a)(7) ([2], above); and
> (c) additional sticker shock (including potential penalties for failure to remit sufficient estimated tax) at some point after filer's upcoming tax year's close.

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All of the harms noted above will be incurred regardless of whether an individual filer's amount of overall tax increase appears relatively low. For example, IRS SOI statistics for 2013 reflect an "average" amount of tax assessed of the 9,144 reported filers whose 990-T taxable income fell between $1 and $9,999 at $3,606).[3] Surely a 40% increase on a similar amount of taxable income (although same is about to increase, as described above in noting the impact of the change set out in [1]) under the new law will not be considered "insignificant" to the affected exempt organizations!

I offer this information in favor of the thousands of small and medium size organizations (social service agencies under 501(c)(3), veterans organizations under 501(c)(4) and 501(c)(19), social clubs under 501(c)(7), other 501(c)(3) public charities and private foundations, and social welfare organizations and fraternal organizations, etc.) who *likely are not yet aware of the impacts I note here.* Certainly their voices are deserving of representation and I hope this information gives ammunition to those who may be in a better position than I to speak for them.

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[1] See IRS Statistics of Information ("SOI") FY 2013 Table 1, reprinted below on slide 41 (annotations have been added by the author, including subtraction of all non-501(c) 990 filers resulting in number text notes). The SOI table may be accessed via https://www.irs.gov/statistics/soi-tax-stats-exempt-organizations-unrelated-business-income-ubi-tax-statistics (download of 2013's Table 1 is available under header "Classified by: Internal Revenue Code Section"). Notes concerning my annotation of this and the table noted in f.n. 2 appear after the reprints of my two slides.

[2] See SOI FY 2013 Table 3, reprinted below on slide 42 (annotations here too have been added by the author, including the highlighting in the header of number of filers reporting UBTI in positive amounts but less than $10,000 as well as those in table's next bracket with UBTI of $10,000 - $99,999, and calculating "average" amount of tax thereupon). The table can be accessed via link noted in f.n. 1 (download of 2013's Table 3 is available under header "Classified by: Size of Unrelated Business Taxable Income or Deficit"). Notes concerning my annotation of this and the prior Table appear after the reprints of my two slides.

[3] *Id.*

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[Remaining three pages are the annotated SOI FY 2013 Tables cited above (i.e., slides 41 and 42) and explanation of the annotations.]

Table 1

NUMBER OF FILED 990-Ts AND AMOUNTS OF INCOME/DEDUCTIONS/TAX – By Type (Tax Year 2013 – data released 10/2016)

Type of tax-exempt organization, as defined by Internal Revenue Code section [Tax year 2013 -- All figures are based on samples]	Number of returns	Gross unrelated business income	Total deductions [1,2]		Total tax [5]	
			Number of returns	Amount	Number of returns	Amount
		$1000s		$1000s		$1000s
	(1)	(2)	(3)	(4)	(9)	(10)
Totals All Orgs	46,380	12,963,173	46,236	12,053,640	23,479	581,003
Totals NOT including 401(a)-408(e)-408(A) [this per presenter]	**34,229**	**12,409,395**	**34,140**	**11,705,361**	**13,353**	**490,081**
115 Income of states, municipalities, etc	48	85,931	48	90,870	7	1,085
401(a) Qualified pension, profit-sharing, or stock bonus plans	876	438,415	871	220,871	709	68,606
408(e) Traditional Individual Retirement Accounts	10,906	99,948	10,856	36,538	9,085	18,456
408(A) Roth Individual Retirement Accounts	369	15,415	369	8,090	332	3,860
501(c)(2) Title-holding corporations for exempt organizations [6]	264	60,333	264	47,605	81	6,850
501(c)(3) Religious, educational, charitable, scientific, or literary organizations	16,416	8,199,608	16,327	8,073,543	6,851	278,773
501(c)(4) Civic leagues and social welfare organizations	1,584	677,943	1,584	660,407	453	11,145
501(c)(5) Labor, agricultural, and horticultural organizations	1,411	237,468	1,411	227,888	690	6,411
501(c)(6) Business leagues, chambers of commerce, and real estate boards	4,714	988,652	4,714	982,921	1,614	23,865
501(c)(7) Social and recreational clubs	5,197	732,989	5,197	704,613	2,314	18,224
501(c)(8) Fraternal beneficiary societies and associations	1,074	103,199	1,074	87,688	256	7,403
501(c)(9) Voluntary employees' beneficiary associations	319	740,385	319	252,889	221	126,646
501(c)(10) Domestic fraternal beneficiary societies and associations	d	d	d	d	d	d
501(c)(12) Benevolent life insurance associations and certain mutual companies	344	75,112	344	67,111	161	3,731
501(c)(13) Cemetery companies	d	d	d	d	d	d
501(c)(14) State-chartered credit unions	1,168	285,539	1,168	367,694	198	3,406
501(c)(19) War veterans' posts or organizations	1,540	196,267	1,540	196,674	429	1,695

https://www.irs.gov/uac/soi-tax-stats-exempt-organizations-unrelated-business-income-ubi-tax-statistics

Table 3

NUMBER OF FILED 990-Ts AND GROSS UBI, TOTAL DEDUCTIONS, UBTI (or Deficit) & TOTAL TAX – By Size of UBTI (or Deficit)

(Tax Year 2013 – data released 10/2016)

Average tax paid: UBTI $1-$9,999 ($5,396,000/9,144 =) $590; UBTI $10k-$99,999 ($37,754,000/5,489 =) $6,878

[All figures are estimates based on samples--money amounts are in thousands of dollars]

Size of unrelated business taxable income or deficit	Number of returns	Gross unrelated business income	Total deductions [1,2]		Unrelated business taxable income (less deficit)		Total tax [3]	
			Number of returns	Amount	Number of returns	Amount	Number of returns	Amount
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Total	**46,380**	**12,963,173**	**46,236**	**12,053,640**	**37,536**	**909,533**	**23,479**	**581,003**
Deficit	13,676	4,605,477	13,676	5,682,492	13,676	-1,077,015	115	3,034
Zero [4]	8,844	2,704,224	8,844	2,704,224	0	0	279	12,836
$1 under $1,000	6,931	71,750	6,931	68,889	6,931	2,861	6,596	582
$1,000 under $10,000	9,463	277,971	9,380	243,851	9,463	34,119	9,144	5,396
$10,000 under $100,000	5,602	889,428	5,552	695,716	5,602	193,712	5,489	37,754
$100,000 under $500,000	1,288	939,901	1,278	645,446	1,288	294,455	1,285	91,510
$500,000 under $1,000,000	262	564,918	262	385,221	262	179,697	260	57,872
$1,000,000 or more	313	2,909,503	313	1,627,800	313	1,281,703	312	372,019

[1] Excludes cost of sales and services, which was subtracted from gross receipts from sales and services in computing gross profit from sales and services. Gross profit from sales and services was a component of gross unrelated business income (UBI). Cost of sales and services can include amounts attributable to depreciation, salaries and wages, and certain other deductible items. For all exempt organizations reporting gross UBI, cost of sales and services was $3.4 billion.

[2] Includes both expenses and deductions reported on Form 990-T, lines 13(B), 29, 31, and 33.

[3] Total tax is the regular unrelated business income tax after reduction by any tax credits (foreign tax credit, general business credit, prior-year minimum tax credit, and other allowable credits), plus the "alternative minimum tax," the "proxy" tax on nondeductible lobbying and political expenditures, and "other" taxes. The proxy tax was reported on Form 990-T and was included in total tax; however, it had no connection to the tax on unrelated business income or an organization's involvement in unrelated business activities. For exempt organizations reporting gross UBI above the $1,000 filing threshold, total proxy tax was $2.4 million.

[4] The Zero category includes 8,844 returns with equal amounts of gross unrelated business income and total deductions.

NOTE: Detail may not add to totals because of rounding.

SOURCE: IRS, Statistics of Income Division, Tax Exempt Organizations, Unrelated Business Income, October 2016.

Guide to annotations within the tables appearing on the preceding two slides:

1. Table 1 (slide 41) Total of 46,380 990-Ts filed in 2013, including those filed who are qualified pension/p-s 401(a)s or IRAs under 408. Not including the non-501s, there are 34,229 filers who are 501(c) or 115. I highlighted the largest 501(c)-subcategories – you will see (1st column) that 16,416 are 501(c)(3)s. The circled last two columns show number of returns within each subcategory that had tax due, with the aggregated tax paid.
2. Table 3 (slide 42) breaks out the number of returns (which include the 401(a)s & IRAs) by SIZE OF UBTI on the return.
   The circled columns are those showing number of returns filed with UBTI between $1k and $9,999 (9,463) and those with UBTI of $10k to $99,999 (5,602), and last column shows the aggregated tax paid by these filers.
3. For both those sub-categories of filers, I calculated the average tax amongst each subcategory (box at top of slide 18):
   - $3,606 is the tax born by the 9,463 filers with UBTI of $1k--$9,999. That tax was based on the pre-TCJA 15% rate, so in 2018 those filers would all face a 40% increase given the 21% rate now imposed: costing each individually on average $1,442 (raising just under $14m for US Treasury)
   - $34,579 is the tax born by the 5,602 filers with UBTI of $10k--$99,999. While we don't have the numbers within this sub-category who had UBTI between $75k--$99,999, all those in that pool whose UBTI was <$75k would have their blended pre-TCJA rate of 18.333% jump by almost 16% to the 21% rate now imposed
4. The remaining sub-categories of those paying tax -- filers whose UBTI was $100k or higher -- numbers ~1,900, and while the amount of aggregate tax they paid (just over $520,000,000) is impressive, it's only these folks who get rate reduction under TCJA!
   (filers with UBTI of $100k have pre-TCJA blended rate of 22.25% -- as the UBTI amount increases, the blended rates climb dramatically, soaring to 34% ultimately)
   - We don't know how many of those ~1,900 filers come from the qualified pension/p-s 401(a)s or IRAs under 408 filers [hereafter, the "non-501(c)s"], but we do know from the prior slide (Table 1, slide 17) that the non-501(c)s are responsible for over $92m in UBIT paid in total
5. Regardless of not being able to pin down the numbers of 501(c)s who are experiencing tax REDUCTION, we know it must be less than the ~1,900 of total taxpayers who would garner same using the results from slide 18

   Speculating here -- if $80m of the $92m paid by those who are non-501(c)s came from those whose UBTI was $100k or more, that would mean they paid ~16% of the tax in those rows
6. We do know that tax INCREASE (or no real change given we don't know the number of taxpayers whose UBTI is in the 90k-100k range where the effective rate under pre-TCJA is close to 21%) is in place for 16,065 filers (total of 501(c)s and non-501(c)s who are the subject of #3 preceding).
7. Ergo, in round numbers, the exempt sector is likely finding that the UBIT rate change correlates to tax reduction **not being in place for 90% of those affected** (based on these 2013 year results)! And, I have to expect (indeed, conclude) that the tax INCREASE pool is largely occupied by smaller and medium size organizations.