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The Tax Cuts and Jobs Acts Provisions Apply to Colleges and Universities

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Although much of the reporting on the Tax Cut and Jobs Act recently enacted by Congress has focused on the deductions for individuals and businesses, the bill also includes several provisions that apply specifically to colleges and universities.

Changes to the unrelated business income tax

Prior to the passage of the Act, a tax-exempt organization would aggregate income from all of its unrelated trades or businesses, then subtract the expenses of those trades or businesses, and the net amount would be subject to the unrelated business income tax. The Act requires that the net income of each unrelated trade or business be taxed separately, so that losses from one unrelated trade or business may not be used to offset business income from another unrelated trade or business. Unused losses from an unrelated trade or business may be carried over to subsequent years.

Excise tax on excessive executive compensation

The Act adds provisions to impose an excise tax on many tax-exempt organizations, including colleges and universities, which provide “excess” compensation to highly compensated employees who are, or have been after 2016, one of the five most highly compensated employees of the organization (a “covered employee”). Compensation is deemed excessive under these provisions in two ways. First, if a covered employee receives W-2 compensation in any year in excess of \$1 million, the excise tax applies to the amount by which the employee’s compensation exceeds \$1 million. Second, if W-2 compensation of a covered employee which is contingent on the employee’s separation from employment exceeds three times the average W-2 compensation paid to that employee over the five years preceding his or her separation from employment (the “base amount”), then the excise tax is imposed on the amount of such W-2

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compensation contingent on separation of employment less the base amount. Note that in calculating the excise tax, the amount subtracted is the base amount, not three times the base amount—which is the safe harbor amount. Note also that deferred compensation of an employee of an exempt organization is now includible in income, as W-2 income, in the year that there is no longer a substantial risk of forfeiture of the right to such remuneration. The excise tax is imposed at the corporate tax rate of 21%.

Elimination of “advance refunding” bonds

Colleges and universities are able to issue “qualified private activity bonds” and interest payable under these bonds is tax-exempt. Under existing law, qualified private activity bonds may be issued to finance the activities of a Section 501(c)(3) organization, and in some cases to “refund” an existing bond at a lower cost to the issuer. The Act repeals the exclusion from gross income of interest on a bond issued to “advance refund” another bond. This provision will apply to any advance refunding bonds issued after December 31, 2017.

Excise tax on the investment income of certain private colleges and universities

The Act imposes a 1.4 percent excise tax on the net investment income of a private college or university that (1) has at least 500 tuition paying students; and (2) has an aggregate fair market value of assets, together with assets of its related organizations which are intended or available for the use or benefit of the educational institution at the end of the year (other than those assets that are used directly in carrying out its tax exempt purpose) of at least \$500,000 per student. Regulations are to be promulgated to describe: (1) what assets are used directly in carrying out the institution’s tax exempt purpose; (2) how to compute net investment income; and (3) what assets of a related organization are intended or available for the use or benefit of the educational institution.

If you have any questions regarding the Act and how it affects your institution, please contact Rob Morris, Keinan Meginniss or any of the attorneys in our Colleges, Universities and Independent Schools practice.

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