

Goodwin Alerts

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New Law Brings Two Significant Changes for Tax-Exempt Organizations

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Speed Read

On December 20, 2019 the Taxpayer Certainty and Disaster Tax Relief Act of 2019 (the “Act”) was signed into law by President Trump as part of a broader spending bill. The Act results in two significant changes for tax-exempt organizations. First, the Act will retroactively repeal the so-called “parking tax”: Code Section 512(a)(7), which when introduced, modified the tax treatment of tax-exempt employers that provide qualified transportation fringes, such as parking and certain transit benefits to their employees. Second, the Act will amend Code Section 4940 to replace the two-tiered excise tax on net investment income of private foundations with a single rate of 1.39%.

RETROACTIVE REPEAL OF CODE SECTION 512(A)(7) (THE “PARKING TAX”)

Enacted pursuant to the 2017 U.S. tax legislation known as the “Tax Cuts and Jobs Act,” Code Section 512(a)(7) imposed an unrelated business income tax on tax-exempt organizations for their expenses in providing certain qualified transportation fringes to their employees. As a result, tax-exempt organizations had to pay a 21% tax on amounts they spent providing certain qualified transportation fringes to employees, including amounts that their employees asked to have withheld from their own paychecks on a pre-tax basis.

Code Section 512(a)(7) caused concern among tax-exempt organizations due to the potential for increased tax liability, lack of clarity and additional administrative burdens.

The Act repeals Code Section 512(a)(7) in full, retroactive to its adoption, opening the door for tax-exempt organizations that have already paid the tax in prior tax years to seek refunds for taxes previously paid. Guidance regarding refund claims has yet to be released by the IRS.

MODIFICATION OF THE TAX RATE FOR THE EXCISE TAX ON INVESTMENT INCOME OF PRIVATE FOUNDATIONS

Code Section 4940 imposed an excise tax of 2% on the net investment income of most domestic tax-exempt private foundations, including private operating foundations. Under Code Section 4940(e), if certain requirements were met, the tax was reduced to 1%.

The Act replaces the two-tiered structure with a single rate of 1.39%, effective for taxable years beginning after the date of the enactment of the Act. While the single rate is lower than the default 2% rate previously imposed, the reduced 1% rate has been eliminated. Accordingly, for private foundations that have been paying the 2% rate, this change represents a rate decrease. However, for private foundations who have been able to meet the requirements for the 1% reduced rate, this change will result in a higher rate.

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