November 13 Tax Update

Both the House and Senate are moving ahead with major tax legislation, with action expected on the House floor and in the Senate Finance Committee the week of November 13. The bills differ in many important respects. However, both treat the charitable deduction the same way.

In short, they retain the charitable deduction but double the standard deduction, while eliminating a great number of other itemized deductions. This would have the effect of reducing the number of taxpayers who itemize charitable gifts from over 40 million to just over 9 million, according to the congressional Joint Committee on Taxation. Removing these taxpayers from the ranks of itemizers would cause a drop in charitable giving of up to $13 billion, according to Indiana University.

On the other hand, while current law allows individuals to deduct up to 50% of their income in gifts of cash, the House and Senate bills would allow them to deduct up to 60%. It appears that this provision was included in order to at least partially offset the expected drop in giving by those who will no longer itemize.

Neither bill includes a provision allowing non-itemizers to deduct their charitable contributions.

Of special importance to art museums, neither bill includes new restrictions on non-cash gifts from individuals.

Private foundation art museums:

The House bill includes a provision on art museums run by private operating foundations. Under current law, private operating foundations, which are a form of private foundation that may use tax-free donations to fund their own activities rather than make grants to other charities, are exempt from a 30-percent excise tax on certain earnings that other private foundations must pay. Under the House provision, an art museum claiming the status of a private operating foundation would not be recognized as such – and thus would lose exemption from the excise tax - unless it is open to the public for at least 1,000 hours per year. The Senate bill includes no such provision.

Estate Tax:

The House bill repeals the estate tax, while the Senate bill would double the current threshold.

Historic Tax Credit:

The House bill repeals the Historic Tax Credit, which promotes preservation and rehabilitation of historic structures, while the Senate retains a limited version of it.

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Excise Taxes:

Both bills would apply an excise tax of 20 percent on compensation of nonprofit executives in excess of $1 million. They would also impose an excise tax of 1.4 percent on private college and university endowments that have assets in excess of $250,000 per student.

Private Activity Bonds:

Under current law, interest on certain private activity bonds, including qualified 501(c)(3) bonds, generally is excluded from gross income (and thus exempt from tax).

The House bill would repeal the exclusion for interest on private activity bonds issued after December 31, 2017 and would make interest on advance refunding bonds issued after that date taxable. The Senate bill only repeals the exclusion for advance refunding bonds.

Electioneering:

The House bill would remove restrictions on 501(c)(3) involvement in political campaigns. The Senate bill includes no provision on this issue. We strongly oppose allowing 501(c)(3) organizations to be involved in campaigns, as it would both place undue pressure on them to support or oppose candidates and possibly divert contributions that would have otherwise been made to them.

Unrelated Business Income Tax:

Under current law, 501(c)(3) organizations that regularly carry on non-mission-related business activities may use a deduction from one unrelated trade or business to offset income from another, thereby reducing total unrelated business taxable income. The Senate bill requires that unrelated business taxable income be computed separately with respect to each trade or business. The organization's unrelated business taxable income for a taxable year would be the sum of the amounts (not less than zero) computed for each separate unrelated trade or business; a net operating loss deduction would be allowed only with respect to a trade or business from which the loss arose. The House bill includes no similar provision.

Intermediate Sanctions:

The Senate bill modifies procedures for establishing the reasonableness of transactions involving "insiders" (e.g., managers and trustees) of 501(c)(3) organizations. The House bill does not.

Both bills includes hundreds of other provisions, so the above is not an exhaustive account, but we believe it covers most areas of particular interest to art museums.

Like-Kind Exchanges:

Both bills would amend Sec. 1031 "like-kind exchanges," which are used to defer capital gains taxes. Sec. 1031 is currently used in transactions involving many kinds of property, including art. Under the House and Senate bills, they would be allowed only for real estate transactions.