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New Tax Legislation's Impact on Political Action and Tax-Exempt Organizations

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Election and Political Law

On December 20, 2017, the Senate and the House voted to pass the conference version of H.R. 1, the Tax Cuts and Jobs Act (the "Act"), and President Trump signed the bill into law on December 22, 2017. Below, we summarize those provisions of the tax reform legislation that are most likely to be of particular interest to political action and tax-exempt organizations.

- **New excise tax on remuneration over $1 million.** The Act imposes on certain tax-exempt employers (and related entities) a new excise tax on compensation paid to the organization's five highest compensated employees. Exempt organizations subject to this excise tax include charities, trade associations, 501(c)(4) social welfare organizations, other organizations exempt under section 501(a) of the Internal Revenue Code (the "Code"), and 527 political organizations. The excise tax is equal to 21% of the employee's remuneration (a) that exceeds $1 million (excluding "excess parachute payments") or (b) certain large separation payments in excess of an employee's five-year average compensation ("excess parachute payments"). The remuneration taken into account for the excise tax is generally the employee's wages that are subject to wage withholding. However, remuneration also includes amounts paid to the employee by a related organization, which include entities that control, or are controlled by, the exempt organization. The provision is effective for taxable years beginning after December 31, 2017.
- **Repeal of deduction for local lobbying expenses.** Generally, a taxpayer cannot deduct for lobbying expenses. Under prior law (i.e., law prior to enactment of the Act), a deduction was allowed for ordinary and necessary expenses incurred in connection with local legislation. The Act repeals the local lobbying exception, and therefore the general disallowance rules for lobbying now apply to costs incurred in connection with local legislation. The provision applies to amounts paid or incurred on or after the date of enactment on December 22, 2017.
- **Full disallowance of deductions for entertainment expenses other than business meals.** The general rule in the Code is that expenses for entertainment are not tax-deductible. Under prior law, entertainment expenses that had a business purpose and that met certain other criteria could be deducted at 50% of the amount expended. The Act disallows deductions for all costs of entertainment (such that not even 50% of the cost would be deductible). The rule would likely apply to expenses incurred for the purchase of game tickets, luxury suites, and the like. Certain food and beverage expenses, however, will continue to be eligible for the 50% deduction. The rule applies to amounts paid or incurred after December 31, 2017.

- **Haircut of deduction for certain meal expenses.** The Code disallows deductions for meal expenses unless they are incurred for a business purpose, in which case 50% of the amount expended is generally deductible. Under prior law, in some circumstances, including when the meals were served on the employer's "business premises," 100% of the meal expenses could be deductible. The Act repeals the "business premises" rule and thus limits the deduction for all business-related meals to 50% of their cost. The rule generally applies to amounts paid or incurred after December 31, 2017. However, for expenses of meals served on an employer's "business premises," amounts paid or incurred after December 31, 2025 are not deductible.
- **Inclusion of certain fringe benefits in UBTI.** Under new Section 512(a)(7), unrelated business taxable income of a tax-exempt entity includes any expenses paid or incurred by such organization for qualified transportation fringe benefits (as defined in section 132(f)), a parking facility used in connection with qualified parking (as defined in section 132(f)(5)(C)), or any on-premises athletic facility (as defined in section 132(j)(4)(B)), provided such amounts are not deductible under section 274. This provision generally replicates a similar provision applicable to taxable entities, which eliminates a taxable entity's deduction for expenses incurred in providing any qualified transportation benefits (except as necessary to ensure the safety of the employee). The provision applies to amounts paid or incurred after December 31, 2017.
- **Retention of ban on political campaign activity by charities.** The original House tax bill contained a provision that would have allowed charitable organizations to participate in political campaign activity under certain circumstances. However, this provision was not included in the final Conference Agreement that became law.

Conclusion

Covington attorneys are continuing to track developments in tax law. If you think you or your organization may be affected by the provisions discussed herein or any other part of tax reform, please let us know.

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