Reform Proposal Would Overhaul Tax Treatment of Students, Employees, and Campus Finances

On Wednesday, February 26, House Ways and Means Committee Chairman Dave Camp (R-MI) released an ambitious “discussion draft” of his “Tax Reform Act of 2014”. It is important to note the draft document has not been introduced as formal legislation and there is little indication that Congress has any interest in taking further legislative action on the tax overhaul at this time, particularly in light of the fact it is a mid-term election year. However, I am compelled to share this update with you as the scope of proposed changes to higher education is extraordinary, impacting students and their families, the higher education workforce, and the fundamental business operations of colleges and universities. While we do not anticipate a sweeping tax package to pass anytime soon, it is possible that certain elements of this package will be considered by policymakers for advancement as stand-alone measures or as part of other legislative proposals.

This update is not intended to be a comprehensive summary of the draft legislation. NACUBO staff continue to examine the details of the 974-page draft legislation, and to explore potential effects—both obvious and ancillary. The House Ways and Means Committee has made helpful resources publicly available, including a section-by-section summary as well as accompanying materials which go into greater detail prepared by the Joint Committee on Taxation.

Broaden the Base, Lower the Rates

Chairman Camp approached the overhaul with several goals in mind, particularly, simplifying the tax code, reducing rates (individual and corporate) and stimulating economic growth. A guiding principle for the members of congress and staff involved in the rewrite of the federal tax code has been, “broaden the base and lower the rates.” The summary document states, “Overall, the changes to the individual rate structure would create a simpler, fairer, and flatter Federal income tax.”

As a result, the seven current individual brackets would be collapsed to three—10%, 25% and 35%. The draft would also significantly increase the standard deduction. To offset the larger standard deduction ($22,000 for joint filers and $11,000 for individuals), Camp eliminates many credits, deductions and exclusions—and thus assumes that more filers will decide against itemizing and opt for the standard deduction. The corporate tax rate would be a flat 25-percent rate beginning in 2019.

In order to highlight the provisions we believe would be of most interest to higher education business officers, we have organized the most significant changes into these areas:

- Student & Family Education Tax Benefits
- Employee Tax Benefits
- Research
- Financing Tax-Exempt Organizations
  - Charitable Giving
  - Tax-Exempt Bond Financing
  - UBIT, Excise Taxes and Penalties

I encourage you to contact Mary Bachinger, director of tax policy, and Liz Clark, director of congressional relations, if you have questions or concerns about the outlook for comprehensive tax reform and the future of the provisions of this proposal.

Sincerely,
Student & Family Education Tax Benefits

The Tax Reform Act of 2014 discussion draft would:

- Modify the American Opportunity Tax Credit (lower income levels for eligibility, increased refundability).
- Require institutions to report amounts paid, rather than amounts billed, on IRS Form 1098-T.
- Repeal the deduction for interest on student loans.
- Repeal the deduction for qualified tuition and expenses.
- Prohibit new contributions to Coverdell education savings accounts. Repeal the Lifetime Learning tax credit.
- Modify the age test for a qualifying child. The present code includes many provisions for taxpayers with children, including personal exemptions. Such provisions require an age test for a qualifying child. In general, under current law, a child must be under age 19 or under age 24 in the case of a full-time student. The Tax Reform Act of 2014 would modify the age test and allow only a child that has not attained age 18 to qualify. It should be noted that the proposal repeals the deduction for personal exemptions, but for other remaining provisions for taxpayers with qualifying children, there would be no accommodation for full-time students.

Employee Tax Benefits

There are a number of new provisions related to employment, particularly in the area of employee benefits. We are highlighting only those proposals particularly impacting colleges and universities:

- FICA Taxes for Foreign Workers: The exemption for certain foreign students and their families in the United States on a temporary basis for educational purposes and to participants in cultural exchange programs would be repealed.
- FICA Taxes for Students: The exemption for students employed by a school, college or university would be limited to the student’s earnings that are less than the amount needed to receive a quarter of Social Security coverage for the year ($1,200 for 2014).
- Employer-Provided Housing: The exclusion for housing provided for the convenience of the employer and for employees of education institutions would be limited to $50,000 ($25,000 for a married individual filing a joint return) and would be limited to one residence.
- Repeal Section 117(d) and Section 127, provisions that enable educational institutions (117d) and employers (127) to provide tax-free educational assistance to certain employees.

Research

- R&D Tax Credit: This research tax credit would be modified, but made permanent.
- Research Income: Income from research not made “publicly available” would be treated as unrelated trade or business income and subject to the UBIT rules.

Financing Tax-Exempt Organizations
Charitable Giving

- **Charitable Deduction Changes**
  - Enable taxpayers to deduct contributions made after the close of the tax year, but before April 15.
  - An individual’s charitable contributions could be deducted only to the extent they exceed 2 percent of the individual’s adjusted gross income, thus creating a “two-percent floor”.
  - AGI limitations on cash contributions and capital gain property would be simplified.
  - The discussion draft would neither extend nor make permanent the “Charitable IRA Rollover” provision that expired on December 31, 2013.

- **College Athletic Event Seating Rights**
  - The special rule that provides a charitable deduction of 80 percent of the amount paid for the right to purchase tickets for athletic events would be repealed.

Tax-Exempt Bond Financing

For bonds issued after 2014, The Tax Reform Act of 2014 would:

- Eliminate Private Activity Bonds. Organizations qualified under Section 501(c)(3) would no longer be eligible to borrow on a tax-exempt basis.
  - Eliminate advance refundings.
  - Apply a de facto 10% surcharge on municipal bonds. The tax preference for earnings on municipal bonds would not be allowed against the 35% individual income bracket.

UBIT, Excises Taxes & Penalties

- **Name and Logo Royalties:** Any sale or licensing by a tax-exempt organization if its names or logo would be treated as unrelated trade and royalties paid with respect to such licenses would be subject to UBIT.
- **Separately computed UBIT:** Tax-exempt organizations would be required to calculate separately the net unrelated taxable income of each unrelated trade or business.
- **Qualified sponsorship payments:** The UBIT exception for qualified sponsorship payments would be significantly scaled back.
- **Intermediate sanctions and self-dealing:** The proposal would dramatically alter intermediate sanctions and self-dealing provisions. Notably, it would eliminate rebuttable presumption of reasonableness for determining executive compensation. Additionally, it would treat investment advisors and athletic coaches as disqualified persons.
- **Supporting organizations:** The current law that allows for the classification of Type II and Type III supporting organizations would be repealed.
- **Endowment Earnings Excise Tax:** Private colleges and universities with assets (other than those used directly in carrying out the institution’s educational purposes) valued at the close of the preceding tax year of at least $100,000 per full-time student, would be subject to a 1-percent excise tax on net investment income.
- **Excise Tax on Executive Compensation:** A tax-exempt organization would be subject to a 25 percent excise tax on compensation in excess of $1 million paid to any of its five highest paid employees for the tax year.
- **Penalties:** The draft introduces a number of new penalties, including a 5-percent penalty applied to managers for any substantial understatement of UBIT.