GRAVES DOUGHERTY HEARON & MOODY

TAX CUT AND JOBS ACT

CLIENT ALERT

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On December 22, 2017, the Tax Cuts and Jobs Act (the "Act") was signed into law. The Act provides for sweeping changes to the U.S. tax system that will impact many different industries and types of taxpayers. Below is a high level summary of some of the provisions of the Act. Many of the Act's changes provide taxpayers with a valuable opportunity to reduce their taxes. Careful planning can help to maximize these savings. Readers should feel free to contact the Graves Dougherty Hearon & Moody, PC ("GDHM") lawyers listed as contacts below to go over additional questions or to find out how the Act's changes impact your individual situation.

Individual Provisions

The Act impacts many aspects of the individual income tax regime, from lowering the highest tax rate to 37% (from 39.6%) to a substantial increase in the individual standard deduction to the elimination of the "individual mandate" previously required under the Affordable Care Act. Unless otherwise noted, the changes described below go into effect on January 1, 2018, and expire on December 31, 2025.

- <u>Income tax rates</u>: Under pre-Act law (and in effect for the 2017 taxable year), there were seven individual federal income tax brackets, ranging from 10% to 39.6%. Beginning on January 1, 2018, the Act reduces the top rate to 37% (for individuals earning at least $500,000 and joint filers earning at least $600,000). The complete tax brackets effective for 2018 are as follows:

	Married Filing Jointly	Head of Household	Single	Married Filing Separately
10%	<$19,050	<$13,600	<$9,525	<$9,525
12%	<$77,400	<$51,800	<$38,700	<$38,700
22%	<$165,000	<$82,500	<$82,500	<$82,500
24%	<$315,000	<$157,500	<$157,500	<$157,500
32%	<$400,000	<$200,000	<$200,000	<$200,000
35%	<$600,000	<$500,000	<$500,000	<$300,000
37%	>$600,000	>$500,000	>$500,000	>$300,000

- Other changes to individual income tax rates include:

  - <u>Increase in the standard deduction</u>: Under pre-Act law, the standard deduction was $12,700 for married couples filing jointly, $6,340 for individuals and married couples filing separately, and $9,350 for heads of households. Under the Act, the standard deduction nearly doubles, becoming $24,000 for married couples filing jointly, $18,000 for single tax payers with at least one qualifying child, and $12,000 for all other tax payers.

  - <u>Repeal of the personal exemption deduction</u>: Taxpayers were previously permitted to claim a "personal exemption" for the taxpayer, the taxpayer's spouse, and any dependents, of $4,050, subject to being phased out at certain income levels. The Act eliminates the "personal exemption" and merges this deduction with the increased standard deduction.

- Simplification of the "kiddie tax": Under pre-Act law, the net unearned income of certain children was taxed at the parents' tax rates if the parents' tax rates were higher than that of the child. Under the Act, trust rates will be applied to the unearned income of a child.

- Changes to Home Mortgage Interest Deduction: Under the Act, for indebtedness incurred after December 15, 2017, the mortgage interest deduction is limited to interest on $750,000 of acquisition indebtedness on newly purchased principal and secondary residences. Additionally, the Act eliminates the deduction of interest on any home equity loan.

- Deduction for estate and local income, sales, and real property taxes: The Act permits a deduction of up to $10,000 for state and local property, income or sales taxes. A separate deduction, however, exists for state and local taxes in connection with carrying on a trade or business.

- Itemized deductions subject to the 2% floor: The Act suspends all miscellaneous itemized deductions that were subject to the 2% floor under pre-Act law. Taxpayers may no longer claim itemized deductions for expenses such as investment management fees, tax preparation fees, and unreimbursed business expenses.

- Individual Alternative Minimum Tax: The Act increases the exemption for the Alternative Minimum Tax ($109,400 for married taxpayers filing jointly; $70,300 for individuals). The Act also increases the phase-out threshold ($1,000,000 for married taxpayers filing jointly; $500,0000 for individuals).

- Capital Gains Tax: Capital gains tax rates generally do not change under the Act. The top rate of 20% for taxpayers in the highest tax bracket will remain the same, as will the "breakpoints" for the 0% and 15% brackets.

- Repeal of overall limitation on itemized deductions: Under pre-Act law, the total amount of most itemized deductions, subject to certain exceptions, was limited for certain taxpayers in the higher income brackets. The Act repeals the overall limitation on itemized deductions.

- Child tax credit: Taxpayers may now claim a $2,000 tax credit for each qualifying child younger than 17 and a $500 tax credit for qualifying dependents other than qualifying children. These credits begin to phase out at an income of $400,000 for married taxpayers filing jointly and $200,000 for all other taxpayers.

- Education savings rules: Certain qualified tuition savings programs that were previously limited to use in connection with higher education have been modified to allow the plans to distribute up to $10,000 per student in a taxable year in connection with enrollment or attendance at a private, public, or religious secondary or elementary school. The definition of "higher education expenses" has also been modified to include expenses related to a homeschool.

- Casualty and Theft Losses: Deduction for personal casualty and theft losses limited to losses attributable to a Presidentially-declared disaster.

- Charitable contributions: The income-based percentage limit for certain charitable contributions of cash to public charities and certain other organizations has been increased from 50% to 60%; no charitable deduction is allowed for contributions made in connection with college athletic seating rights.

- Medical Expenses: For the taxable years ending before January 1, 2019, the threshold for deducting medical expenses is decreased to 7.5% of adjusted gross income for all taxpayers (under current law, the threshold is generally 10%).

- Alimony: For divorce agreements executed after December 31, 2018 (or prior divorce agreements modified after that date), alimony is not deductible and is not included in the income of the recipient.

- Moving expenses: The deduction for moving expenses is generally repealed, other than for members of the Armed Forces on active duty moving pursuant to a military order. Qualified moving expense reimbursements (other than those for members of the Armed Forces) are no longer excluded from gross income.

- Elimination of the "Individual Mandate": Under the Affordable Care Act, individuals who are not covered by a health care plan that provides at least minimum essential coverage are subject to a tax. This tax, commonly known as the "individual mandate," has been eliminated by the Act.

- ABLE accounts: The Act temporarily increases the contribution limit to ABLE accounts (which are tax-advantaged savings accounts for individuals with disabilities and their families) under certain circumstances. While the overall limitation on contributions ($14,000 for 2017) remains the same, the limit is temporarily increased with respect to contributions made by the designated beneficiary of the ABLE account. After the $14,000 limit in contributions is reached, an ABLE account's designated beneficiary may contribute an additional amount, up to the lesser of (i) the Federal poverty line for a one-person household or (ii) that individual's compensation for the taxable year. Additionally, the Act temporarily allows a designated beneficiary of an ABLE account to claim the saver's tax credit for contributions made to his or her ABLE account.

- Rollovers between qualified tuition programs and qualified ABLE programs: ABLE programs are tax-favored savings programs intended to benefit disabled individuals. Under the Act, amounts from qualified tuition program accounts may now be rolled over to qualified ABLE accounts without penalty if the ABLE account is owned by the designated beneficiary of the qualified tuition program account or a member of that beneficiary's family.

New Deduction for Pass-through Income

- Special deduction for pass-through income: Under the Act, an individual, trust or estate will be able to deduct 20% of qualified business income ("QBI") from a pass-through entity (i.e. a limited liability company, partnership, S corporation or sole proprietorship). At the new top individual tax rate of 37%, if the taxpayer's sole income source is QBI, their effective top tax rate would then be 29.6% (if able to claim the full 20% deduction). The deduction is taken "below the line" (i.e., it reduces your taxable income but not your adjusted gross income), but it is available regardless of whether you itemize deductions or take the standard deduction. In general, the deduction cannot exceed 20% of the excess of your taxable income over net capital gain. If QBI is less than zero it is treated as a loss from a qualified business in the following year.

- Qualified business income: QBI for a tax year means the net amount of items of income, gain, deduction and loss with respect to your trade or business. If the computation of QBI results in a loss, the amount of the loss will be carried forward and treated as a loss from a qualified business in the next tax year. The business must be conducted within the U.S. to qualify, and specified investment-related items are not included, including capital gains or losses, dividends and interest income (unless the interest is properly allocable to the business). The trade or business of being an employee does not qualify. Also, QBI does not include reasonable compensation received from an S corporation, or a guaranteed payment received from a partnership for services provided to a partnership's business. Other limitations may apply in certain circumstances, including for taxpayers with qualified cooperative dividends, qualified real estate investment trust (REIT) dividends or income from publicly traded partnerships.

- Phase-in for taxpayers above income thresholds: For taxpayers with taxable income above $157,500 (or $315,000 if married, filing jointly), an exclusion from QBI of income from "specified service" trades or businesses is phased in. These are trades or businesses involving the performance of services in the fields of health, law, consulting, athletics, financial or brokerage services, or where the principal asset is the reputation or skill of one or more employees or owners. If your taxable income is at least $50,000 above the threshold (i.e., $207,500, or $157,500 + $50,000), all of the net income from the specified service trade or business is excluded from QBI. If your taxable income is between $157,500 and $207,500, you would exclude only that percentage of income derived from a fraction of the numerator of which is the excess of taxable income over $157,500 and the denominator of which is $50,000. So, for example, if taxable income is $167,500 ($10,000 above $157,500), only 20% of the specified service income would be excluded from QBI ($10,000/$50,000). (For joint filers, the same operation would apply using the $315,000 threshold, and a $100,000 phase-out range.)

- Limitation based on W-2 wages and capital: The Act also modifies the wage limit applicable to taxpayers with taxable income above the threshold amount(s) listed above to provide a limit based either on wages paid or on wages paid plus a capital element. If your taxable income is at least $50,000 above the threshold (i.e., $207,500, or $157,500 + $50,000), your deduction for QBI cannot exceed the greater of (1) 50% of your allocable share of the W-2 wages paid with respect to the qualified trade or business, or (2) the sum of

25% of such wages plus 2.5% of the unadjusted basis immediately after acquisition of tangible depreciable property used in the business (including real estate). So if your QBI were $100,000, leading to a deduction of $20,000 (20% of $100,000), but the greater of (1) or (2) above were only $16,000, your deduction would be limited to $16,000 (i.e., it would be reduced by $4,000). And if your taxable income were between $157,500 and $207,500, you would only incur a percentage of the $4,000 reduction, with the percentage worked out via the fraction discussed in the preceding paragraph. (For joint filers, the same operations would apply using the $315,000 threshold, and a $100,000 phase-out range.)

Corporate (and Other Business) Provisions

- Flat 21% Rate: The Act taxes corporate income at a flat 21% rate and repeals the maximum corporate tax rate on net capital gain. The provision is effective for tax years beginning after December 31, 2017. This change in corporate rate changes the traditional choice of entity analysis such that now, in certain circumstances, a corporation may be the most tax efficient vehicle for an entity. Taxpayers interested in corporations as a tax efficient vehicle will need to become familiar with pre-existing law regarding the accumulated earnings tax of Section 53 (dealing with accumulated earnings beyond the reasonable needs of a business) and the personal holding company tax of Section 541 (dealing with incorporated "talents" or "pocket-books").

- Reduction of dividends received deduction: Pre-Act law allowed a corporation to deduct certain amounts with respect to dividends received from other taxable domestic corporations. The amount of the deduction generally equaled 70% of the dividend received. Under pre-Act law, where a dividend was received from a 20%-owned corporation, the amount of the deduction equaled 80% of the dividend received. Under pre-Act law, where a dividend was received from a subsidiary member of the same affiliated group, the amount of the deduction equaled 100% of the dividend received. Under the Act, the 70% dividends received deduction is reduced to 50% and the 80% dividends received deduction is reduced to 65% in order to reflect the lower corporate tax rate.

- Increased Expensing: Pre-Act law allowed taxpayers to claim additional depreciation (i.e., bonus depreciation) under Section 168(k) in the year in which qualified property (as described later) is placed in service through 2019 . The bonus depreciation generally equaled 50% of the cost of the property placed in service in 2017 and phased down to 40% in 2018 and 30% in 2019. Under pre-Act law, qualified property is defined as tangible property with a recovery period of 20 years or less under the modified accelerated cost recovery system (MACRS), certain off-the-shelf computer software, water utility property or qualified improvement property, and, to be eligible for bonus depreciation under pre-Act law, the original use of the property must have begun with the taxpayer. The Act extends the additional first year depreciation deduction through 2026. The Act allows taxpayers to claim 100% bonus depreciation with respect to qualified property acquired and placed in service after September 27, 2017, and before January 1, 2023. The Act phases down bonus depreciation to 80% for qualified property placed in service before January 1, 2024; 60% for qualified property placed in service before January 1, 2025; 40% for qualified property placed in service before January 1, 2026; and 20% for qualified property placed in service before January 1, 2027. The Act also expands the definition of qualified property by repealing the requirement that the original use of the property begin with the taxpayer; instead, property is generally eligible for 100% bonus depreciation if it is the taxpayer's first use of such property (provided that such "used" property is not acquired from a related party or in a carryover basis transaction). The Act further expands the current law definition of qualified property to include certain qualified film and television productions, as well as certain qualified theatrical productions.

- New Limitations on Interest Deductions: The Act limits the net interest expense deduction for every business, regardless of form, to 30% of adjusted taxable income. The Act requires the interest expense disallowance to be determined at the tax filer level. Adjusted taxable income is a business's taxable income calculated without taking into account: (i) any item of income, gain, deduction, or loss which is not properly allocable to a trade or business; (ii) any business interest or business interest income; (iii) NOLs; (iv) the amount of any deduction allowed under Section 199A (relating to the deduction for income from certain pass-through businesses); (v) in the case of tax years beginning before January 1, 2022, any deduction allowable for depreciation, amortization or depletion; and (vi) such other adjustments as provided by the Secretary. The Act allows businesses to carry forward interest amounts disallowed to succeeding tax years indefinitely. Importantly, the Act exempts from these rules businesses (other than tax shelters) with average annual gross receipts of $25 million or less for the three-tax-year period ending with the prior tax year. The provision also would not apply to certain regulated public utilities and, at the taxpayer's election, any real property trades or businesses. These interest deduction limitations are effective for tax years beginning after December 31, 2017.

- Modification of net operating loss deduction: Under pre-Act law, Section 172 allows taxpayers to carry back a net operating loss (NOL) arising in a tax year for two years and carry forward the NOL for 20 years to offset taxable income. The Act allows indefinite carry forward of NOLs arising in tax years ending after December 31, 2017; however, the Act repeals all carrybacks for losses generated in tax years ending after December 31, 2017. For losses arising in tax years beginning after December 31, 2017, the Act limits the amount of NOLs that a taxpayer could use to offset taxable income to 80% of the taxpayer's taxable income.

- Repeal of Section 199: The domestic production activities deduction of Section 199 is repealed for non-corporate taxpayers for years beginning after December 31, 2017, and for C corporations for tax years beginning after December 31, 2018.

- Repeal of Corporate AMT: The corporate alternative minimum tax is repealed for tax years beginning after December 31, 2017.

Partnership (and Other Pass-through Business) Provisions

- Change to Carried Interest Rules: Before passage of the Act, gain or loss recognized on the sale or exchange of a capital asset was characterized as long-term capital gain if the asset was held for more than one year, and such gain allocated by a partnership to a partner retains its long-term capital gain character as if the gain were recognized directly by the partner. The Act changes this law with respect to what is commonly referred to as a carried interest. The Act would add a new Section 1061. That provision would change the one-year holding period under Section 1221 to a three-year holding period for certain capital gains of a taxpayer with respect to carried interests (defined as applicable partnership interests). An applicable partnership interest would be one transferred to (or held by) a taxpayer in connection with the performance of services by the taxpayer or certain related persons in an "applicable trade or business." If the three-year holding period requirement is not satisfied, any capital gain recognized by the carried interest holder would be treated as short-term capital gain, taxable at a partner's marginal income tax rate (e.g., as high as 37%). The provision would not otherwise change the nature or character of the income, and would apply notwithstanding the application of Section 83 to the carried interest or whether a Section 83(b) election was made by the holder with respect to the carried interest. The provision would be effective for tax years beginning after December 31, 2017.

- Partner loss limitation to include charitable contributions and foreign taxes: In applying the Section 704(d) basis limitation on partner losses, pre-Act law did not take into account a partner's share of partnership charitable contributions and foreign taxes paid or accrued. The Act would modify the basis limitation on partner losses under Section 704(d) to include the partner's share of partnership charitable contributions and foreign taxes. The provision would be effective for partnership tax years beginning after December 31, 2017.

- Mandatory basis adjustments for transfers of partnership interests with built-in losses: The Act would expand the scope of the mandatory basis adjustment rules of Section 743(d). In addition to the current requirement that a partnership adjust the basis in its assets upon the sale of a partnership interest if the partnership has a built-in loss of more than $250,000 in its assets, the Act would require a basis reduction if the purchaser of the partnership interest would be allocated a loss of more than $250,000 with respect to the purchased interest upon a hypothetical taxable disposition by the partnership of all of the partnership's assets for cash equal to the assets' fair market value, immediately after the transfer of the partnership interest. The provision would be effective for transfers of partnership interests after December 31, 2017.

- Technical terminations upon sale or exchange of 50% of interests in partnership profits and capital: Under pre-Act law Section 708(b)(1)(B), a sale or exchange of 50% or more of interests in partnership capital and profits within a 12-month period causes a "technical termination" of the partnership. The Act repeals Section 708(b)(1)(B) for partnership tax years beginning after December 31, 2017.

- Sales of partnership interests by foreign partners: In *Grecian Magnesite* (Grecian Magnesite Mining v. Commissioner, 149 T.C. No. 3 (July 13, 2017)), the Tax Court declined to follow Revenue Ruling 91-32, holding the gain recognized by a foreign person on its redemption from a partnership engaged in a U.S. trade or business did not result in effectively connected income (ECI). The Act would effectively reverse that decision, codifying a result similar to that of the ruling, such that gain or loss from the sale, exchange or disposition of a partnership interest by a foreign partner is treated as ECI if the partner's share of the gain or loss from the sale or exchange of the underlying assets held by the partnership would be treated as ECI. In addition, the transferee of a partnership interest subject to the new rule would be required to deduct and withhold 10% of the amount realized on the disposition unless, among other things, the transferor certifies that the transferor is not a foreign person (similar to the operation of the FIRPTA rules applicable to sales of U.S. real estate by foreign owners). The provision would be effective for sales, exchanges and dispositions on or after November 27, 2017, while the effective date for required withholding on sales of partnership interests would be effective for sales, exchanges, and dispositions after December 31, 2017.

- Limitation on Deduction of Interest: The limitation on deduction of interest discussed above under the "**Corporate Provision**" heading would also apply to partnerships.

- Non-corporate loss limitation: The Act limits excess business losses for non-corporate taxpayers for tax years beginning after December 31, 2017, and before January 1, 2026. Excess business losses are defined as the excess of the taxpayer's aggregate deductions attributable to trades or businesses of the taxpayer over the excess of aggregate gross income or gain of such taxpayer for the tax year that is attributable to such trades or businesses, plus $250,000 (200% of such amount in the case of a joint return). Disallowed excess business losses will be treated as a net operating loss carryforward to the next year under Section 172. For partnerships and S-corporations, these rules are applied at the partner or S-corporation owner level. These rules will be applied after the application of Section 469 (the passive loss limitation rules). These rules apply to tax years beginning after December 31, 2017.

Overhaul of U.S. International Tax System

- Establishment of territorial tax system: Under pre-Act law, U.S. taxpayers were generally subject to tax on their worldwide income, wherever derived. The Act completely overhauls this system with respect to U.S. corporations and establishes a "territorial" system of taxation, under which U.S. corporations (not individuals) may deduct dividends received from a "specified" foreign corporation held for one year.

- Mandatory taxation of deferred foreign earnings at reduced rate: U.S. corporations and certain individuals who own at least 10 percent of the voting shares of a foreign corporation must take into current income, beginning in 2017, their pro rata share of the untaxed earnings of the corporation. This income is subject to tax at either 15.5 or 8 percent depending on whether such earnings are attributable to cash or tangible assets of the foreign corporation. Dividends paid in 2017 to U.S. shareholders subject to these rules will be taxed at these rates and not at normal rates. Taxpayers may elect to defer payment of the actual additional taxes resulting from this mandatory inclusion over an eight-year period. The first payment will be due on the date when the taxpayer's final tax payment for 2017 is otherwise due.

- Retention of rules requiring inclusion of income upon investment in U.S. property by a controlled foreign corporation (CFC): The Act retains the current rule that results in the taxation of offshore earnings corresponding to an investment in U.S. property made by a CFC.

- Special tax rates for offshore intangible income: The Act provides for an overall domestic corporate tax rate of 21 percent. However, it also provides special tax rates for foreign intangible income earned directly or indirectly through a CFC. The Act imposes a 13.125 percent effective tax rate for intangible income earned directly and a 10.5 percent rate for intangible income earned through a foreign corporation.

- No extension of 'look-through' rules for certain CFCs: The Act does not extend an expiring rule that characterizes income received from a controlled foreign corporation by reference to the underlying income of the controlled foreign corporation.

- Base erosion and anti-abuse tax (BEAT): To prevent the erosion of the U.S. corporate tax base, the Act imposes a 10 percent tax (5 percent for 2018) on U.S. corporations that make excessive tax-deductible payments to related foreign persons. The rules apply only to corporate taxpayers with average annual gross receipt of at least $500 million, and only if they have a 'base erosion percentage' of 3 percent or higher.

- Definition of intangibles: The Act contains rules that ensure that goodwill, going concern value and workforce in place will be taxed if transferred to a foreign corporation.

- "Fair market value" method of apportioning interest expense for purposes of determining foreign tax credits: Pre-Act law allows taxpayers to elect the fair market value method of apportioning interest expense, which may benefit taxpayers that have significant intangible assets with high value but low tax basis. The Act disallows the use of this method, forcing taxpayers to apportion based on tax basis.

Estate, Gift and Generation-Skipping Transfer Tax

- Increased Exemption Amount: Pre-Act law provides tax payers with an exemption ($5 million, indexed for inflation) for gifts made by them during their lives and for assets included in their gross estate upon their death. In 2017, the exemption amount was set at $5.49 million per person ($10.98 million for married couples). Under the Act, the exemption amount will be raised to $11 million, indexed for inflation. For 2018, the exemption amount will be $11.2 million per person ($22.4 million for married couples).

- Generation-Skipping Transfer Tax: Gifts made to beneficiaries more than one generation below the donor (i.e., grandchildren, great-grandchildren, etc.) are subject to an additional tax known as the generation-skipping transfer tax. Pre-Act law provides for a $5 million exemption (indexed for inflation) for gifts that would be subject to the generation-skipping transfer tax, with the exemption amount being set at $5.49 million in 2017. Under the Act, the generation-skipping transfer tax exemption amount is increased to $11 million indexed for inflation. The generation-skipping transfer tax exemption will be set at $11.2 million in 2018.

- Sunset: The increased exemption amounts are not permanent, however. Pursuant to the Act, the increased exemption amounts will sunset on December 31, 2025, and will revert back to their pre-2018 levels ($5 million, indexed for inflation) beginning on January 1, 2026.

- Marginal Tax Rate: Under pre-Act law, the marginal tax rate for the estate and gift tax and for the generation-skipping transfer tax is 40%. This will remain unchanged under the Act.

Procedural

- Time to Contest IRS Levy Extended: For levies made after the date of enactment (12/22/17), and for levies made on or before the date of enactment if the 9-month period has not expired as of the date of enactment, the 9-month period during which the IRS may return the monetary proceeds from the sale of property that has been wrongfully levied upon is extended to 2 years. The period for bringing a civil action for wrongful levy is similarly extended from 9 months to 2 years.

Changes to Business Credits

- The tax credit rate for clinical testing expenses for certain drugs for rare diseases or conditions has been reduced from 50% to 27.5%.

- The Act repeals the 10% rehabilitation credit for pre-1936 buildings, but retains the 20-percent credit for qualified rehabilitation expenditures with respect to a certified historic structure, with modifications.

- A new employer credit for paid family and medical leave allows eligible employers to claim a general business credit equal to 12.5% of the amount of wages paid to qualifying employees during any period in which such employees are on family and medical leave if the rate of payment under the program is 50% of the wages normally paid to an employee. The credit is increased by 0.25% (but not above 25%) for each percentage point by which the rate of payment exceeds 50%.

Like Kind Exchanges

- Like Kind Exchanges Only for Real Property: The Act repeals like kind exchange treatment for all property other than real property not held primarily for sale. This is effective for transfers after December 31, 2017.

Exempt Organizations

- Unrelated business income separately computed for each trade or business activity: For a tax-exempt organization with more than one unrelated trade or business, the Act now requires that unrelated business taxable income first be computed separately with respect to each trade or business and without regard to the specific deduction generally allowed under Section 512(b)(12). The result is that a deduction from one trade or business for a taxable year may not be used to offset income from a different unrelated trade or business for the same taxable year.

- Excise tax based on investment income of private colleges and universities: The Act imposes an excise tax on applicable educational institutions of 1.4% of the net investment income of that institution for the taxable year. An "applicable educational institution" means an institution: (1) that has at least 500 tuition paying students during the preceding taxable year (more than 50% of whom are located within the U.S.); (2) that is an eligible education institution as described in section 25A of the Code; (3) that is not described in the first section of section 511(a)(2)(B) of the Code (i.e., state colleges and universities); and (4) the aggregate fair market value of the assets of which at the end of the preceding taxable year (other than those assets that are used directly in carrying out the institution's exempt purpose) is at least $500,000 per student.

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