



# TAX REFORM KEY CHANGES

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NAFCU and our members thank Senate Finance Committee Chairman Orrin Hatch, R-Utah, House Ways and Means Committee Chairman Kevin Brady, R-Texas, and every other member of Congress who had a hand in crafting this “Tax Cuts and Jobs Act” for recognizing the benefits of credit unions’ tax exemption. NAFCU continues to analyze the bill for any potential short- and long-term impacts to credit unions. Below we have provided you with analysis from our review of the most important provisions affecting credit unions.

## **CREDIT UNION TAX EXEMPTION STATUS**

The Act does not change or alter the current credit union federal tax status in any way. Even though the legislation eliminated many of the current credits, deductions, and exemptions for small and large businesses; NAFCU was able to work with members of the House and Senate to ensure preservation of the credit union tax status because of the importance of the credit union mission.

## **DEFERRED AND EXECUTIVE COMPENSATION**

The original House and Senate tax bills eliminated 457 deferred compensation plans. During the tax negotiations, NAFCU and our members met with members of Congress, including Chairman Brady and Chairman Hatch, to discuss the importance of the credit union deferred compensation plans. Those conversations were productive and the Act maintains the ability for credit unions to offer deferred compensation plans.

The Act, however, creates an employer-paid 21 percent excise tax on executive compensation over \$1 million. This applies all tax-exempt organizations, including both federal and state-chartered credit unions. Tax-exempt employers would be responsible for paying this tax on the five highest-paid individual employees (including former employees for applicable taxable year) who have individual compensation in excess of \$1 million annually. Executive compensation includes employee total compensation (including benefits, except those to a tax-qualified retirement plan, such as Roth IRA plans and 457(b) deferred compensation plans, and amounts not included in gross income). In calculating the \$1 million threshold, non-qualified deferred compensation will be treated as income for the first taxable year when there is no substantial risk of forfeiture of the rights to such

compensation. Any deferred compensation accrued on or after January 1, 2018, would be treated as income upon vesting, and would be subject to the 21 percent excise tax owed by the employer (if the employee is or would be put over the \$1 million dollar threshold in an applicable year).

## **RETIREMENT ACCOUNTS**

Despite efforts to create limitations on the availability of pre-tax contributions to 401(k) retirement plans, Congress decided to leave retirement plans largely untouched after receiving powerful pushback from taxpayers in all sectors of the economy. The Act did make some minor changes though, including changes to a rule regarding the ability to convert funds in traditional IRAs to Roth IRAs. Currently, taxpayers have the ability to convert funds from a pretax IRA to a post-tax Roth IRA and pay tax on the money that is converted. Taxpayers also currently have the ability to change their minds and undo this conversion through a process called recharacterization. The Act has repealed the rule allowing recharacterization of a Roth IRA back into a traditional IRA after a conversion.

## **MORTGAGE INTEREST TAX DEDUCTION**

With NAFCU members playing a significant role in the mortgage lending industry, we were relieved to see the mortgage interest deduction maintained with modifications in the Act. Earlier in the year there had been discussions surrounding tax reform about completely eliminating or drastically altering the mortgage interest deduction altogether. The final Act will not affect current homeowners; it would allow them to continue to deduct the interest paid on up to \$1 million of mortgage debt. New homebuyers will only be able to deduct the interest on up to \$750,000 of their mortgage principle on home purchases scheduled to close on or after January 1, 2018. The new cap expires at the end of 2025.

It is important to note that the MITD only applies to those filers who opt not to take advantage of the new standard deduction, which is \$12,000 for individuals and \$24,000 for joint filers under the Act. Those individuals who opt to still itemize, will also be able to deduct up to \$10,000 in state and local property taxes under the bill.

## **HOME EQUITY LOAN INTEREST DEDUCTION**

Homes equity loans and lines of credit are a key source funding for homeowners. The Act limits the deductibility of interest paid on some home equity loans/lines of credit for loans beginning after December 31, 2017, depending on the purpose of the loan. The Internal Revenue Code currently distinguishes between "acquisition" debt, meaning loans to buy, build or substantially improve a main or second home, and other "home equity" debt. The

Act does not alter this distinction, but eliminates the deduction of "home equity" debt and limits total "acquisition" debt to \$750,000. Existing home equity lines of credit may also not be "grandfathered" into receiving the deduction. Additionally, beginning in 2018, any interest accrued on certain existing home equity loans/lines of credit may not be deductible. The suspension expires at the end of 2025. NAFCU is working with tax professionals as this provision is interpreted and will provide you with the most accurate interpretation of the Act's changes.

## **UNRELATED BUSINESS INCOME TAX**

Currently, the Internal Revenue Code provides that state-chartered credit unions must pay tax on any income that is unrelated to their regular trade or business (UBIT); federal credit unions are exempt from UBIT requirements because they are instrumentalities of the Federal government. Under the Act, credit unions already subject to Unrelated Business Income Tax (UBIT) will no longer be allowed to deduct certain employee fringe benefits as business expenses. As a result, credit unions will be required to pay taxes on certain benefits, including transportation and parking benefits, as well as on-site gyms and athletic facilities. The new taxes will apply to amounts paid or incurred after December 31, 2017.

## **STATE AND LOCAL TAX (SALT)**

Current federal tax law allows for individuals who itemize their deductions to deduct the entirety of their state and local income taxes, sales tax, and property taxes from their federal income tax return. The Act removes the ability to deduct the entire amount by setting a cap for a maximum deduction of \$10,000 combined for all state, local, and property taxes. This cap will take effect in tax year 2018 and remain in place until 2026.

## **SMALL BUSINESS LOAN INTEREST DEDUCTION**

The Act preserves the deduction for interest on small business loans, including ones made by credit unions. Such loans are an essential source of credit for the individuals running America's small businesses, which are the backbone of our economy. These loans are also critical because they allow small businesses to meet many of their day to day cash flow needs. Small businesses benefit greatly from the ability to deduct the interest paid on these loans. The Act imposes new limitations on the deductibility of interest for certain entities, however, small businesses with average annual gross revenue that does not exceed \$25 million will still be able to deduct interest paid or accrued on their small business loan. Therefore, credit unions can continue to expect demand from their members for small business loans.

## CHANGES TO THE TAX CODE FOR BANKS

Although not directly impacting credit unions, one provision of note that impacts banks is the phase out of the business tax deduction on premiums paid to the FDIC to support the Deposit Insurance Fund for banks with assets above \$10 billion. Currently these are deductible as a trade or business expense. Banks under \$10 billion in assets will continue to have fully deductible premiums, but this will be phased out for those banks with assets from \$10-\$50 billion and be completely non-deductible for those with total consolidated assets above \$50 billion. Other changes to the tax code could have an impact on banks as well, including cuts in the corporate income tax rate, and changes to the tax rates providing relief for owners of Subchapter S corporations. Nearly one-third of all banks are S-corporations.

## CONCLUSION

Thanks to NAFCU's persistent advocacy, this monumental piece of legislation keeps the credit union tax exemption fully intact. This is a testament to the value and strength of credit unions. NAFCU's recent study on the value of the credit union tax exemption demonstrates just how important the credit union tax exemption really is to our nation's economy. You can access the study at [nafcu.org/cutaxexemption](http://nafcu.org/cutaxexemption). Despite this win, the Act does contain several other provisions that directly affect credit unions and their members and employees.

Although tax reform legislation has passed and been signed into law, congressional leadership has indicated that they intend to work on a technical corrections bill to fix any errors that may be found in the Act and also move a tax extenders bill in early 2018 to address expiring programs. NAFCU will continue to work with Congress to defend the credit union tax exemption and advocate for credit unions as changes to the tax system are implemented and technical corrections are considered.