



INSIGHTS FROM THE **BLOG** OF THE BDO INSTITUTE FOR NONPROFIT EXCELLENCESM

TAX REFORM IS HERE, SO WHAT'S NEXT FOR NONPROFITS?

By BDO Nonprofit Tax Leaders

The Tax Cuts and Jobs Act, signed into law on December 22, marks the largest overhaul of U.S. tax policy in decades.

WHAT ARE THE CHANGES FOR NONPROFIT ORGANIZATIONS?

Reviewing the 1,000-plus pages of the Act is a daunting task for nonprofits. To help organizations navigate the key provisions affecting nonprofits, we've summarized top considerations and implications below.

PROVISION	IMPLICATIONS FOR NONPROFITS
<p>Increase the Standard Deduction: The Act nearly doubles the standard deduction for individuals and married couples filing jointly. The increase would be from \$6,350 to \$12,000 for individuals and from \$12,700 to \$24,000 for married couples, adjusted for inflation.</p> <p>Limit the State and Local Tax Deduction: The deduction for state and local taxes is limited to \$10,000.</p>	<p>While an increase in the standard deduction benefits taxpayers, the increase, combined with the limitation on the deduction for state and local taxes, will cause fewer individuals to itemize, which many nonprofits fear may lead to a reduction in overall giving. It has been estimated by the Tax Policy Center that charitable giving will decline by between \$12.3 billion and \$19.7 billion.</p> <p>One nonprofit wish list item that did not make it into law is the idea of a "universal" charitable deduction, which would be available to all taxpayers, whether they itemize or not. This provision, many organizations argue, would not only increase the motivation for people to give, but would send Americans a message on the importance and value of giving.</p>

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<p>Increase the Charitable Contribution Deduction Limit: The Act increases the charitable contribution deduction limit for an individual to 60 percent of his or her adjusted gross income (AGI), up from the current limit of 50 percent for cash donations to public charities..</p>	<p>The increase in deduction limits appears to be an incentive for high-income donors to give more to charity, as they can claim more of their donations as a charitable deduction.</p>
<p>Repeal the "Pease" Limitation: The Act repeals the "Pease" limitation (named after former Senator Donald Pease), whose original intent was to raise tax revenue by increasing the taxable income for high-income earners. It does this by reducing the value/benefits of several itemized deductions (including charitable contributions) once a taxpayer's AGI reaches a certain amount (\$261,500 for single filers and \$313,800 for married couples filing jointly). The suspension of this limitation sunsets in 2025.</p>	<p>Since the "Pease" limitation reduced the benefits of itemized deductions (including charitable contributions), repealing it allows high earning taxpayers to go back to enjoying the full benefits of these deductions. It is anticipated that this measure could help prompt high earners to donate more to charity.</p>
<p>Tickets to College Athletic Events: The Act repeals prior law that allows a donor who makes a contribution to a college or university and receives priority seating at athletic events in return, to take a charitable contribution deduction of 80 percent of the amount donated.</p>	<p>The new law treats the value of receiving priority seating at athletic events as equivalent to the contribution made and therefore no charitable contribution deduction is allowed.</p>
<p>Impose an Excise Tax on Executive Compensation: Imposes a 21 percent tax on the compensation of covered employees in excess of \$1 million and employees receiving certain parachute payments. A 'covered employee' is any employee (including former employees) of the organization if the employee a) is one of the five highest compensated employees of the organization for the taxable year, or b) was a covered employee of the organization (or any predecessor) for any preceding taxable year beginning after Dec. 31, 2016. Certain medical professionals are excluded from the definition of a covered employee.</p>	<p>Tax-exempt organizations will need to factor this new excise tax into their overall tax planning and be aware that this extra payment may require budget cuts elsewhere. The compensation taken into account includes compensation from related organizations, both tax exempt and taxable. A related organization is an organization that controls, or is controlled by, the organization (parent/subsidiary); is controlled by one or more persons that control the organization (brother/sister); and/or is a supported or supporting organization.</p>
<p>Increase the Estate Tax Exemption: The law doubles the gift and estate tax exemptions from \$5 million to \$10 million (adjusted for inflation) per individual beginning in 2018.</p> <p>This provision will sunset in 2026, returning the exemptions to their current level.</p>	<p>An increase in the estate tax exemptions could significantly reduce the incentive for people to make charitable bequests, as more property can now be transferred to beneficiaries tax-free.</p>
<p>Impose an Excise Tax on Endowments of Nonprofit Colleges & Universities: The bill includes a new excise tax of 1.4 percent on the net investment incomes of applicable educational institutions. The term 'applicable educational institution' refers to an educational institution which a) had at least 500 tuition-paying students during the preceding taxable year; b) the aggregate fair market value of the assets of which at the end of the preceding taxable year (other than those assets which are used directly in carrying out the institution's exempt purpose) is at least \$500,000 per student of the institution; and c) more than 50 percent of the tuition-paying students are located in the United States.</p>	<p>The new law only applies to private institutions. Under the new law, an educational institution will have to include the assets of related organizations when making the determination of whether the thresholds are met. Many initially thought the provision would only impact between 30 and 60 colleges and universities. However, large healthcare systems and other exempt groups may have nursing schools or other schools that could be impacted when the assets of the related entities are considered.</p>

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<p>Modifications to the Unrelated Business Income Tax (UBIT)</p> <p>Losses: The Act disallows tax-exempt organizations to take the business losses from one economic activity and deduct them from the gains of another economic activity. Organizations could, however, use one year's losses on the same unrelated business to reduce taxes on another year's operation of the same unrelated business.</p>	<p>There are many unanswered questions about the UBIT provision and there may be opportunities for tax planning. On the other hand, the corporate income tax rate is decreased from 35 to 21 percent, which means nonprofits will pay a lower tax rate on the UBIT than they are currently.</p>
<p>Certain Fringe Benefits: Unrelated business income of a tax-exempt organization would include employer costs for qualified transportation fringe benefits and parking facilities.</p>	<p>These provisions were enacted to equalize the treatment between taxable corporations that can no longer deduct these amounts and nonprofits.</p>
<p>Changes to the Tax-Exempt Treatment of Interest Income from Advance Refunding Bonds: Nonprofits often use advance refunding bonds to help reduce the cost of borrowing to finance projects like construction or other capital investments.</p> <p>The Act repeals the exclusion from gross income for interest on a bond issued to advance refund another bond. Interest paid to advance refunding bond investors is now taxable.</p>	<p>The change limits bond issuers to current refundings in order to maintain the exclusion for the interest received by bondholders.</p>

ON THE CUTTING ROOM FLOOR

One provision of particular interest to nonprofits failed to make it into the law—the repeal of the Johnson Amendment. The House bill included a provision that have enabled nonprofits to express their favor for a certain political candidate, even under the Johnson Amendment, which is designed to protect 501(c)(3) organizations from the demands from political candidates and donors for political endorsements and campaign contributions.

Reactions to the potential repeal were mixed, with some saying it could make nonprofits vulnerable to political demands by donors, while others thought it provided organization with freedom of speech, but at a level that would still prevent them from becoming political organizations. Although it was not included in the final version of the tax reform law, the President has long been talking about his desire to lift these restrictions, so we may see this debate resurface in the coming years.

Other provisions that were not enacted but could have significantly impacted nonprofits included limitations on the royalty exclusion from UBIT, the elimination of the Rebuttable Presumption of Reasonableness, and the extension of the Intermediate Sanctions provisions (IRC 4958) to 501(c)(5) and (c)(6) organizations.

LOOKING FORWARD

After a dramatic push to the finish line, tax reform is finally here. Nonprofits stand to be impacted significantly by various aspects of the new law, and will need to reassess their tax positions for financial reporting purposes.

Nonprofits, which often struggle with a lack of internal capacity, need to be sure to allocate adequate resources to deal with these changes. And, the impact of the new law extends beyond just the provisions for tax-exempt organizations. Many of the changes on the individual level, i.e. limiting state and local tax deductions, nearly doubling the standard deduction and the estate and gift tax exemptions—could leave organizations facing significant cutbacks in donations. Comprehensive fiscal management that takes a holistic approach including the tax, audit, fundraising, and executive functions will be more vital than ever in 2018.

Here are five steps nonprofits should take now to tackle tax reform:

1. **Assess impact.** Tax professionals will likely need to review the law to measure their organization's specific circumstances against it to assess the impact of each provision, as well as the holistic effect on their bottom line.
2. **Assemble a team.** While the heaviest burden may fall on accountants, companies and their finance teams will have an important role to play to gather all the necessary data.
3. **Dig into the data.** Assessing the impact of tax reform requires a substantial amount of data to be readily available. Nonprofits need to move from modeling the impact of tax reform to focus on data collection and computations as soon as possible.
4. **Establish priorities.** Focus on the areas that could have the greatest impact on your organization.
5. **Initiate tax reform conversations with your tax advisor.** Tax reform of this magnitude is the biggest change we've seen in a generation, and will require intense focus to understand not only how the changes apply at a federal level, but also how to navigate the ripple effect this is likely to have on state taxation as well.

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