HOW TAX REFORM IMPACTS NONPROFITS
(AND THEIR DONORS)

The 2017 Tax Cuts and Jobs Act resulted in several key changes to the tax code for individuals and businesses alike. This latest round of tax reform also brings significant implications for charitable giving, with both non-profits and their donors feeling the effects.

What's new

Some of the new tax law changes affect charitable giving directly, others indirectly. Here's what tax reform holds for nonprofits and donors:

1. HIGHER AGI LIMITS FOR CASH GIFTS.

Previously, the tax code capped the allowable deduction for cash donations to public charities at 50% of adjusted gross income (AGI). The Tax Cuts and Jobs Act increases that limit to 60%, which may encourage taxpayers who itemize to increase cash donations to public nonprofits. Taxpayers who are eligible for the deduction will be able to carry it forward for up to five years.

2. GIFT, ESTATE AND GENERATION-SKIPPING EXCLUSIONS DOUBLE.

The Tax Act maintains a top tax rate of 40% for gift, estate, and generation-skipping taxes. But, the Act doubles the basic exclusion amount (which is the amount of assets that can be sheltered from these taxes) to $10 million, adjusted for inflation. The limit doubles once again for married couples filing jointly.

From a nonprofit perspective, the increased limit may be a mixed bag. On the one hand, there may be more opportunities for charitable giving among donors if they're less likely to trigger the estate tax. On the other, there may be less incentive for wealthier donors to use charitable giving to avoid estate tax.

3. THE STANDARD DEDUCTION INCREASES.

Deductions are great for reducing taxable income, and the tax reform law raises the standard deduction amounts across the board. The deduction now stands at $12,000 for single filers, $18,000 for heads of household and $24,000 for married couples who file a joint return.

For donors, a higher standard deduction could mean a simpler tax filing. The most immediate impact for nonprofits is that a higher standard deduction could shrink the number of taxpayers who itemize (and are thus eligible to deduct charitable donations) from 37 million to about 16 million.[1]

4. TAX BRACKETS GET A FACELIFT.

The Tax Act retains the seven-bracket system but changes individual income tax rates. The highest marginal rate of 37% applies to single filers and heads of household earning $500,000 or more, and married couples filing jointly with a combined income of $600,000 or more.

So how does that have the potential to affect charitable giving? The marginal tax benefit of deducting charitable donations is expected to drop from 20.7% to 15.2%, according to the Tax Policy Center.[2] Middle-income earners are likely to see the biggest drop in their tax benefit when deducting charitable giving, but wealthy donors will also see their marginal benefits decline.

5. PEASE LIMITATIONS ARE REPEALED.

The Pease limitations are effectively a surtax on itemized deductions, designed to curtail how much higher-income taxpayers were able to write off in previous tax years. Under the new tax law, the Pease limitations disappear, which is a good thing for taxpayers who land in a higher tax bracket (and potentially nonprofits who receive their donations). The repeal boosts the value of itemized deductions, including deductions for charitable giving.

6. THE COLLEGE ATHLETIC EVENT SEATING DEDUCTION IS OUT.

Under the previous tax law, it was possible to deduct 80% of contributions made for the right to purchase priority seating for collegiate athletic events. This rule was a boon for colleges and universities because it encouraged giving. With the deduction going away, it's possible that nonprofit schools could see this donation stream shrink.

7. PRIVATE COLLEGES COME UNDER CLOSER TAX SCRUTINY.

As part of the Tax Act, private colleges and universities face a new excise tax of 1.4% on net investment income. The tax applies to private institutions with assets of $500,000 or more for each full-time student and a minimum enrollment of 500 students.

The Act doesn't, specify how net investment income is to be calculated. And while certain endowment assets are exempt from the rule, there are no clear guidelines yet on what's covered by the exemption. The rule may not affect donor giving, but it could force private schools to rethink their investment and endowment strategies.

8. NONPROFIT EMPLOYERS ARE TARGETED BY A NEW TAX.

Nonprofits that employ millionaire executives are now subject to a hefty 21% excise tax under the new tax law. This tax kicks in on compensation of $1 million or more for the top five highest-paid employees, excluding bonuses and stock options.

HOW NONPROFITS CAN ADAPT

Some of the measures included in the Tax Act could make charitable giving less appealing tax-wise. But, that shouldn't deter nonprofits from continuing to strengthen relationships with their existing donors, while taking steps to attract new ones.

Nonprofits also have an opportunity to emphasize lesser-used avenues for tax-advantaged giving in the wake of tax reform. For example, donors subject to required minimum distribution rules may realize a tax benefit when making charitable donations from a traditional individual retirement account.

It's important to recognize that the changes enacted through the Tax Cuts and Jobs Act affecting individual taxpayers aren't permanent. They'll expire at the end of 2025 unless Congress extends them. When shaping their charitable giving outlook, nonprofits must remember to keep the short-term tax outlook in view, without losing sight of their long-term philanthropic mission.

Sources:
[1]http://www.taxpolicycenter.org/model-estimates/impact-itemized-deductions-tax-cuts-and-jobs-act-jan-2018/t18-0009-impact-tax
[2]http://www.taxpolicycenter.org/model-estimates/charitable-contributions-and-tcja-nov-2017/t17-0336-effective-marginal-tax-benefit

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