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The Practical Effect of Tax Reform: What Nonprofits Need to Know for Fundraising and Other Legal Compliance

Paul H. Livingston, Jr.
Edward T. Chaney
Peter G. Mattocks
Guilford Nonprofit Consortium
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Fundraising and Planned Giving

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Standard Deduction Doubles: Details

- The standard deduction has doubled- $24,000 for married couples, $18,000 for head of household and $12,000 for individuals
- Many expenses that qualified as itemized deductions under prior law no longer qualify (for example, income tax preparer fees) and itemized deductions for state and local taxes are limited to $10,000 per return
- This will result in fewer itemized returns- perhaps as few as 5% of total returns filed will itemize deductions
- Will the charitable sector be harmed significantly?
  - Logically, yes; however there is substantial evidence that the prime motivation for giving is not a tax deduction (See U.S. Trust Study of High Net Worth Philanthropy)
  - Time will tell

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Standard Deduction Doubles: How to Adjust

- Consider “bunching” donations in one year and using standard deduction in other years
  - For example: Donor, a taxpayer who itemizes deductions, normally gives $10,000 to various charities per year. The donor could create a donor advised fund (DAF) with $40,000 and then advise DAF to distribute $10,000 per year to those charities. If the donor wished to support a single charity on an annual basis and wanted that annual support to continue, the donor could create an (or support an existing) organizational endowment at a community foundation to support the single charity with annual distributions from the endowment.
  - In the year the donor makes the $40,000 donation to a DAF or organizational endowment, the donor’s itemized deductions will exceed the standard deduction. In intervening years, the donor can take the standard deduction.

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Standard Deduction Doubles: How to Adjust

- Under the new law, donating certain appreciated assets will continue to be beneficial
  - Gifts to a public charity of certain appreciated assets, such as marketable securities or real estate, results in a deduction equal to full market value of such assets at time of transfer
  - But the donor does not have to recognize appreciation of assets as income

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Standard Deduction Doubles: Does Not Negatively Impact Charitable Rollover

- Individuals with an IRA account are generally required to take a minimum distribution from that IRA every year starting at age 70 ½
- Instead of taking the minimum distribution, an individual can undertake a “charitable rollover” of all or part of that required minimum distribution and no income tax will be due on the amount passing to charity
- The charitable rollover is limited to $100,000 per year
- The charitable rollover is only available for IRAs
- If an individual is 70 ½ but the retirement assets are in a 401(k) plan, if the plan permits, the individual can take in service withdrawal and rollover to an IRA in order to take advantage of charitable rollover in the future

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Estate Tax Changes: Details

- The estate tax exclusion amount, that is the amount that can pass at death without estate tax, has doubled-
  - Pre-2018: $5 million adjusted for inflation per person, and $10 million, also adjusted for inflation, per married couple
  - 2018-Dec. 31, 2025- $10 million adjusted for inflation per person, and $20 million also adjusted for inflation, per married couple
  - Gift tax and generation skipping tax exclusion amounts are the same as the estate tax exclusion amount
  - For 2018, the exclusion amount is $11,180,000 per person

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Estate Tax: What Did Not Change

- Charitable gifts at death still result in an unlimited charitable deduction for estate tax purposes
  - E.g. John Doe dies with $50 million estate and directs all amounts not subject to estate tax to go to his alma mater and all amounts within the estate tax exclusion amount to his brother
  - If John dies in 2018, $11,180,000 goes to his brother, $38,820,000 goes to alma mater, and $0 is due in estate tax
- The estate tax previously applied only to few people, but now to even fewer people

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Estate Tax Changes: How to Adjust

- With so few estates now subject to estate tax, consider soliciting gifts during life and allowing donors to take advantage of an income tax deduction
  - Remember “bunching” technique
- Consider discussing changes to existing estate plans of which you are aware that benefit your organization and notifying donors about how new changes will affect charitable intent
  - Consider Jane Doe, who made an estate plan many years when the estate tax exclusion amount was $1 million. During that year Jane had assets of $5 million. Her estate plan directed the maximum allowable exclusion amount to her daughter and any amount subject to estate tax to her favorite charity, the Salvation Army.

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Estate Tax Changes: How to Adjust

- Jane Doe example (cont.)
  - Jane dies in 2018 with $8 million in assets. Because her estate plan was based on any amount subject to estate tax passing to charity and anything not subject to estate tax to her daughter, her daughter now gets her entire estate and the Salvation Army gets nothing.
- What can Jane and her favorite charity do to avoid this?
  - Re-draft estate plan so that a minimum amount goes to charity
  - Give amounts during life and take income tax deductions
  - If the standard deduction is causing a problem, consider “bunching”
  - If 70 ½ or older, consider a charitable rollover

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Estate Tax Changes: How to Adjust

- Further considerations regarding retirement plans
  - Individual/non-charitable beneficiaries of IRAs and other qualified retirement plans pay income tax on amounts distributed to them from such accounts
  - Charities, of course, do not get taxed on such distributions
  - Consider, then, using an IRA or another qualified retirement plan to make charitable contributions, and to the extent that one wishes their family to have a certain amount or percentage of assets, use non-retirement assets in estate

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Other Changes from the Tax Law

- The maximum amount deductible for cash gifts to public charities and certain (few) private foundations increased from 50% of Adjusted Gross Income (AGI) to 60% of AGI
  - Not likely to have a significant effect
  - Note that it is only applicable to gifts of cash, not other assets like appreciated marketable securities
- Donations related to college sports tickets
  - Pre-2018: A taxpayer could take a deduction of 80% of the value of a donation that was made in order to allow taxpayer to purchase tickets to college sporting events
  - Note that the value of the tickets could never be deducted

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Other Changes from the Tax Law

- Donations related to college sports tickets (cont.)
  - Now, there are no deductions allowed on amount donated that allow a person to buy tickets to sporting events
  - The new tax law specifically instructs the IRS to write regulations to counter any abuse/schemes whereby deductions are still taken
  - Colleges and Universities are considering how to respond to this major change

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Summary of Steps Charitable Organizations/Donors to Consider

- Given the tax law changes, what should charities consider doing:
  - Do you make the case in solicitations that donations are more necessary than ever because you anticipate some former donors will no longer donate if they lose the ability to take a tax deduction or just respond to concerns of donors when expressed?
  - Emphasize non-tax reasons for donations
  - Consider beneficial use of “bunching” and communication on this with donors as appropriate
  - Actively solicit donations of retirement plan assets, including charitable rollovers
  - To the extent that you are aware of donors planning to benefit your organization via the donor’s estate plan, review available documentation to see if donations are based on amounts passing per the estate tax exclusion amount and see if given current exclusion, that estate plan still meets the wishes of the donor

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Summary of Steps Charitable Organizations/Donors to Consider

- Continue to monitor future changes in the tax law
  - Congress can change the law at anytime and if charitable giving suffers extensively, it is possible that changes could come

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Remember the Sunset

- To get the tax reform law passed, Congress put a "sunset" date on almost all of the tax provisions not related to corporate tax cuts
  - Generally, all of the tax provisions mentioned in this presentation are scheduled go away on the last day of 2025
  - At that time, the pre-2018 tax law comes back into effect (e.g. the "old" standard deduction amount and "old" estate tax exclusion amount)
  - But, Congress can always extend some or all of the provisions

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Operational Considerations – Effect of Tax Reform and Other Recent Developments

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UBIT & New Anti-Siloing Provision

- BACKGROUND: Tax exempt organizations pay “unrelated business income tax” or UBIT on net income earned from trades or business not substantially related to their exempt purposes
  - Most passive income (e.g. rent, interest) is exempted or excluded except where financed by debt (e.g. a mortgage on a rental property)
- NEW: Losses from one trade or business can no longer offset revenue from another trade or business
  - Uncertainly in application:
    - What makes a trade or business separate from another?
    - Are passive sources treated individually? What about debt-financed income?
- ADDITIONAL NOTE: Corporate vs Trust UBIT Tax Rates

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UBIT & Certain Fringe Benefits

- BACKGROUND: Certain fringe benefits, such as qualified transportation benefits, can be provided to employees on a tax-free basis.
- NEW: Going forward, exempt employers that provide these certain fringe benefits to employees must pay UBIT to the extent such expenses would be taxable if the employer were not exempt.
  - Provision is generally meant to put exempt and non-exempt employers on the same footing – but why UBIT instead of excise tax?
  - Employers may look to include these benefits in employee income (effectively passing the tax on to the employees)

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Executive Compensation Tax

- Tax exempt organizations that compensate employees more than $1 million must pay an excise tax
  - Intended to put taxable and tax-exempt entities on same footing
  - Taxed at applicable corporate rate (21%)
  - Applies to five highest paid employees (current or past – for tax years ending after Dec. 31, 2016)
  - Compensation includes most retirement payments and deferred compensation, either when vested or when no longer subject to substantial risk of forfeiture, depending on the plan
  - Includes compensation paid by related entities
  - Uncertain application to certain government-related organizations

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Other Provisions Less Broadly Felt

- Tax on some private university endowments
- Clarifies that tax-exempt organizations (and their donors) cannot rely on Form 990 reporting to fulfill required substantiation of charitable contributions
- Advance refunding bonds not eligible for tax-free treatment
- Expenses for local lobbying efforts are not deductible
  - Affects calculation and reporting of dues payments to non-charitable entities

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Other Notable Recent Developments

- Donor-Advised Fund Guidance – Notice 2017-73
  - Bifurcation NOT permitted – e.g. membership or special event payments
  - Safe harbor for payments that may fulfill pledges:
    - the sponsoring organization makes no reference to the existence of a charitable pledge when making the DAF distribution
    - donor doesn't receive any other non-incidental benefit
    - donor does not take another charitable contribution deduction as a result of the distribution
  - For public support test purposes, IRS is <u>considering</u> treating DAF distributions as coming from the donors and not the sponsoring charity (subjecting amounts to applicable limitations)
  - IRS is also scrutinizing whether private foundations can make qualifying distributions to DAFs

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Other Notable Recent Developments

- IRS concentrating on using Form 990 data to drive audit program
  - Filers need to approach forms with more care and understanding
- Parks Foundation case: Private foundation radio ads deemed to be lobbying (impermissible for private foundations)
  - Underscores need for social media policies or monitoring
- #MeToo movement beginning to implicate nonprofit leaders and organizations
- “Newman’s Own” private foundation exception
- Revisiting the Johnson Amendment

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Compliance Check

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Key Compliance Considerations

- What should you be doing as a nonprofit operating in North Carolina?
  - File the applicable Form 990 (Form 990-EZ, Form 990N, Form 990-PF, or Form 990) every year
  - Apply for/renew charitable solicitation license with NC and any other states in which you are registered
  - Provide donors with letters of acknowledgement for gifts
  - Attain applicable state tax exemptions
  - Follow donor restrictions

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Form 990 or Related Federal Filing

- Nonprofits must file a Form 990, or related filing each year
- Generally, the due date is 5.5 months after the close of your year (e.g. due each May 15 for calendar year organizations) but a six-month extension (via filing Form 8868) is available
- So, that means for a calendar year organization, final 990 due date is November 15 of the following year
- Who files what:
  - Private Foundation= 990-PF
  - $50,000 or less in gross receipts= 990-N (postcard)
  - $50,000 to $200,000 in gross receipts + total assets of no more than $500,000= Form 990-EZ
  - More than $200,000 in gross receipts or more than $500,000 in total assets= Form 990

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Charitable Solicitation Licensing

- NC
  - If a nonprofit solicits for donations among NC residents/in NC, it generally needs to make an initial and annual filing with the NC Secretary of State
    - If the nonprofit receives $25,000 or more in private grants and contributions per year, it needs a solicitation license
    - If nonprofit receives less than $25,000, it may be eligible to be exempted
    - Certain nonprofits are exempt by statute- e.g. churches and schools.
  - When is the filing due?
    - Fifth month and 15th day after year ends, with a three month extension available
    - Note that this does not line up with the IRS extension of six months

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Charitable Solicitation Licensing

- Other states
  - Most states require a solicitation license if you solicit and raise more than a de minimis amount from residents in that state.
  - What is “soliciting”?
    - Each state has their own definition, but generally it is the <u>affirmative act of asking for contributions of assets for a charitable purpose</u>
      - Includes mail, telephone, email, and personal solicitations for assets
      - Includes asking for money, real property, personal property
      - Laws are meant to protect the public such that public can be assured that they are donating to legitimate charitable causes
      - Some states provide that asking for money from members of an organization does not constitute solicitation
      - Examples of typical types of charitable solicitations
        - Holding a fundraising dinner where participants are asked to donate in order to attend
        - Sending a mass email to a listerv asking for funds for a charitable cause

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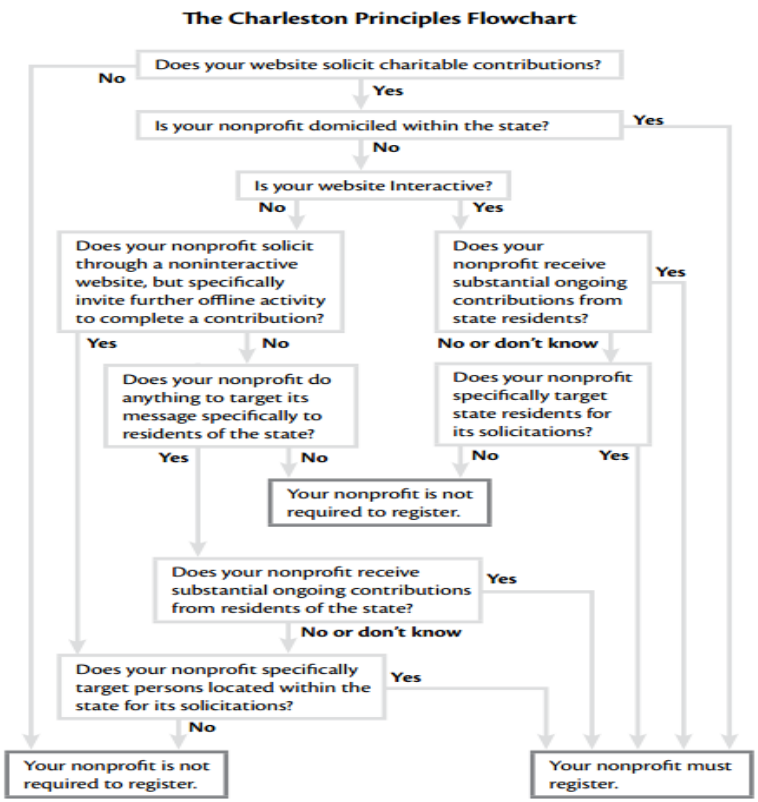
Charitable Solicitation Licensing

- What about online fundraising/"donate now" button?



Source: Nonprofit Fundraising Registration: The 50-State Guide, Nolo, 2nd Ed, Nov 2012, by Stephen Fishman & Ronald Barrett

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Charitable Solicitation Licensing

- A frequently asked question: “When should my organization register in another state?”
  - Short answer: When the law of that other state requires you to
  - But this is not really helpful from a practical perspective
  - Think about the following considerations:
    - Is the organization consistently raising money in that state?
    - How is the organization raising money in that state/is it asking for money?
    - If the organization lost donations or the ability to get donations from that state, would be it a severe problem?
    - Is the amount raised more than a de minimis amount?
    - Would the organization be eligible for an exemption in that state based on amount raised or the nature of the organization?

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Charitable Solicitation Licensing – Other Parties

- Note that if a nonprofit uses an outside, paid fundraiser, that person will be subject to similar licensing requirements
- Also commercial co-ventures (e.g. pairing with a for-profit where a nonprofit gets a dollar on every sale of an item) have licensure or reporting requirements

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Substantiation of Gifts – Cash

- For all cash donations, donor must have written evidence that includes certain information.
- Contributions of $250 or greater need a written substantiation with the name of the donee, amount of contribution, and either:
  - a statement that no goods or services were provided;
  - description and good faith estimate of the value of goods or services, if any, that organization provided in return; or
  - a statement that goods or services, if any, that the organization provided in return for the contribution consisted entirely of intangible religious benefits

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Substantiation of Gifts – Quid Pro Quo Contributions

If in excess of $75, the acknowledgment must:

(1) Inform donor that the amount of the contribution that is deductible is limited to the excess of value contributed by the donor over the value of goods or services provided by the organization in return, and

(2) provide a donor with a good-faith estimate of the fair market value of these goods or services.

Failure to comply can result in a penalty of $10 per contribution, subject to a $5,000 cap.

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Substantiation of Gifts – Non Cash Gifts

- Generally, charities must substantiate in writing all non-cash gifts regardless of value.
- If $250 or more, must include a statement that no goods or services were provided, or a description and good faith estimate of the value of goods or services.
- If $5,000 or more, charity must sign donor's Form 8283 (unless the gift is solely publicly traded securities). In addition, the charity may need to file a Form 8282 if it disposes of the property within three years.
- Donors may have other substantiation and record keeping requirements.

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NC State Tax Exemptions

- NC Exemptions
  - Corporate Income and Franchise Tax Exemption- Attained through NC Department of Revenue and linked to 501(c)(3) federal status
  - Sales and Use Tax- Generally 501(c)(3) nonprofits are eligible for sales tax refunds on purchases made in furtherance of mission. The nonprofit needs to establish proper status as a nonprofit to the NC Department of Revenue and then it would file semi-annually Form E-585 with NC Department of Revenue as well.
  - Real and Personal Property Tax Exemption- This is handled on the county level and generally involves an application to the relevant county authority

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Donor Restrictions

- Many nonprofits are left money through a will or provided funds by a gift instrument that contains various provisions on use that create an endowment
- The Uniform Prudent Management of Institutional Funds Act (UPMIFA) applies to these gifts generally- states have their own versions of UPMIFA
- NC's UPMIFA creates default interpretations or may override the provisions of certain gift instruments in certain circumstances
- Rule of thumb: Know and follow the donor restrictions in gift instruments, keep documents permanently, document board/officer decisions regarding outgoing funds from endowments

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ATTORNEYS AND COUNSELORS AT LAW

Questions?

Paul H. Livingston, Jr.

plivingston@schellbray.com

Edward (Ed) T. Chaney

echaney@schellbray.com

Peter G. Mattocks

pmattocks@schellbray.com

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