

From Challenges to Opportunities: How Nonprofits Can Make Sense of the New Tax Law

On December 22 2017, the federal Tax Cuts and Jobs Act (TCJA) was signed into law. The Act is the most sweeping federal tax bill to be enacted in over 30 years. It will impact all types of nonprofits - small, medium, and large. It will make real the tax reform risks outlined in this publication last year, including a drop in Massachusetts charitable giving of up to \$500 million per year.

This edition of Commonwealth Insights looks at the TCJA's impacts on nonprofits and strategies for dealing with the Act. It includes a focus on changes to the standard deduction, which will make giving more expensive for many middle-income donors. Nonprofits of all types, and those who support the sector, must work together to ensure that nonprofits are able to continue their vital work in the wake of tax reform.

KEY POINTS:

- Tax reform will have significant impacts on nonprofits.
- The doubling of the standard deduction will increase the cost of donations for middle-income donors, threatening a drop in their giving.
- Tax reform presents an opportunity for nonprofits to engage more deeply on public policy issues affecting the sector.
- Tax reform should also spur nonprofits to strengthen their fundraising practices.



- **Estate Tax** - The TCJA maintained the estate tax but doubled the exemption to almost \$11 million for individuals and \$22 million for couples. This will present challenges for nonprofits that depend on estate and planned giving. Studies estimate that it will lower charitable giving nationally by \$4 billion per year.
- **Fringe Benefits** - The TCJA imposes a UBIT penalty of 21% on the amount nonprofits pay for employees' onsite gym membership and/or commuting/parking expenses. Nonprofits will still be able to offer these types of fringe benefits, but may have to change how they are paid for. The IRS has additional guidance on this issue.
- **Increase in Giving Limits** - The TCJA raises the limit on write-offs of cash donations for taxpayers who itemize their deductions, up to 60% from its current 50% of adjusted gross income. This change could be helpful for some nonprofits. It will apply to a shrinking number of taxpayers who will continue to itemize their deductions.

I. How Will Tax Reform Affect Nonprofits?

Nonprofits should make sure that they are aware of, and in compliance with, the changes affecting them in the TCJA. A number of provisions directly related to nonprofits are listed below. MNN advises nonprofits to consult with their accountants and attorneys for guidance on how these provisions will apply to individual organizations.

- **IRA Rollovers** - The TCJA changed the requirements regarding IRA rollover gifts to charity. Beginning at age 70 ½, taxpayers can now make gifts directly to charitable nonprofits without having to count them as part of their taxable income.
- **Pease Limitation** - The Pease limitation, which reduces the dollar value of itemized deductions for some high-income taxpayers by 3% over a set threshold, was abolished in the TCJA. For high-income donors, this change will restore any decreased tax benefit resulting from the lowering of individual income tax rates.
- **Public Policy Implications** - The TCJA will have impacts far beyond the federal tax code. It is projected to increase the federal deficit by more than \$100 billion per year over the next 10 years. That will put pressure on state budgets, which depend heavily on federal dollars. State and local governments will also be challenged by the Act's cap on the deductibility of state and local taxes. Nonprofits that receive funding from, or otherwise work with, governments may see impacts.
- **Unrelated Business Income Tax (UBIT)** - The TCJA changes the way some nonprofits will calculate their UBIT. Before TCJA, nonprofits calculated their UBIT on an organization-wide basis. Going forward, nonprofits will need to calculate unrelated business income for each business separately, resulting in increased UBIT payments for some.

II. The New Standard Deduction - *A Threat to Fundraising*

Since it was introduced over 100 years ago, the federal charitable tax deduction has incentivized charitable giving in the United States. While the TCJA did not directly alter that deduction, its changes to the standard deduction will dramatically impact charitable giving. Those changes will significantly reduce the number of taxpayers who itemize their deductions. As a result, many millions of taxpayers around the country will no longer benefit from the federal charitable tax deduction.

The federal charitable tax deduction is only available to those who itemize their tax deductions. Prior to the TCJA, 30% of filers nationwide and 37% in Massachusetts itemized. Under the TCJA,

The Tax Policy Center estimates that the number of tax filers itemizing will decline by over 27 million, or 60% nationwide.

which increased the standard deduction to \$12,000 for single filers and \$24,000 for those married filing jointly, millions of taxpayers will no longer itemize their taxes. The Tax Policy Center, a joint venture of the Brookings Institution and the Urban Institute, estimates that the number of tax filers itemizing will decline by over 27 million, or 60% nationwide. Going forward, filers who will take the standard deduction will be unable to utilize the federal charitable tax deduction. This will increase the cost of charitable contributions for these filers by their marginal tax rate, most commonly 28%. MNN anticipates that over half a million Massachusetts tax filers will be in that category, potentially resulting in a drop of hundreds of millions of dollars in their annual giving.

This risk is compounded by the importance of individual donations to nonprofits. In MNN surveys, 80% to 90% of members report that they rely on individual donations. MNN also expects that most of the donors affected by this change will be middle-income donors. Most lower-income donors have not itemized deductions in the past. Most high-income donors have itemized, and will continue to do so because their deductions will exceed the new standard deduction thresholds. It's middle-income (c. \$50,000 - \$150,000/year) donors that will see their cost of giving increase, by an average of 28%.

III. How Should Nonprofits Respond - *Public Policy*

It has always been important for nonprofits to stay educated about, and engaged with, public policy issues. Three issues are especially significant in the wake of federal tax reform. MNN will work on them in the months and years ahead, and encourages nonprofits across Massachusetts to join in the effort. They are:

- **Building support for a universal charitable tax deduction** - MNN, along with a national coalition of partners, supports the creation of a universal

How the Standard Deduction Raises the Cost of Giving

2017



The López family earns \$90,000 a year in pretax income.



\$3,000

They gave \$3,000 annually to charity.

They received a \$840 charitable tax deduction for their contributions because they itemized.

\$840

2018



With the doubling of the standard deduction, the López family no longer itemizes their contributions. Their **cost of giving** increases in 2018. To stay within their budget, they give less to charity.



\$2,160

The López family does not receive a charitable tax deduction for their contributions.

\$0

charitable tax deduction. While effective, the current federal charitable tax deduction is not available to the over 100 million Americans who do not itemize their taxes. A universal deduction would be available to all, regardless of what taxpayers earn or whether they itemize their taxes. A universal charitable tax deduction would also eliminate the negative impacts of doubling the standard deduction.

- **Implementing the Massachusetts state charitable tax deduction** - Via a ballot question in 2000, Massachusetts voters approved the creation of a state income tax deduction for charitable contributions. This deduction was available to taxpayers regardless of whether they itemized deductions on their federal income tax returns. The deduction was only in place for a year before it was suspended as part of a tax package to close a deficit in the state budget. Under current

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law, this deduction will return in 3-4 years if economic growth continues. MNN is in the initial stages of educating lawmakers about the importance of this deduction and how it can promote further charitable giving in the Commonwealth.

- **Protecting the tax-exempt status of nonprofits** - The TCJA included new taxes on the sector (a large-university endowment tax and a tax on high employee salaries). While they currently impact a small percentage of nonprofit organizations, they represent a break from the social compact between government and the nonprofit sector. Under long established federal and state law, nonprofits are tax-exempt, recognizing the common good served by nonprofits. MNN will continue to educate lawmakers about the ways in which the sector's tax-exempt status helps ensure that nonprofits have the resources needed to fulfill their missions.

IV. How Should Nonprofits Respond - Fundraising

As outlined above, federal tax reform will place additional strains on fundraising, particularly for nonprofits that depend on middle-income donors.

CALL TO ACTION:

What nonprofits can do to prepare for the changes and opportunities ahead

ADVOCACY

- Build support for a universal charitable tax deduction
- Work for the re-implementation of the Massachusetts state charitable tax deduction
- Protect the tax-exempt status of nonprofits

FUNDRAISING

- Go “back to the basics”: diversify revenue streams and adopt donor-centric fundraising
- Engage boards of directors in advocacy, fundraising
- Cultivate corporate partnerships
- Employ new methods of donor engagement
- Implement monthly, yearly, or planned giving programs

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Yet the common wisdom on fundraising remains: people give to nonprofits for a wide variety of reasons besides the tax benefits. Donors’ relationships with nonprofits and the feeling of “doing good” they receive from donating are both compelling motivations.

Nonprofits should communicate the potential impacts of tax reform to their boards of directors, staffs, and donors, and galvanize their participation in the following fundraising strategies:

- **“Back to the Basics”** - The “basics” consist of diversifying revenue streams and adopting donor-centric fundraising practices. Diversifying revenue streams strengthens a nonprofit’s balance sheet, and broadens its network of supporters. Donor-centric fundraising focuses on donors’ interests, to connect their philanthropic goals with an organization’s mission.
- **Board Engagement** - Boards of directors can play a key role in strengthening a nonprofit’s impact and advocating on behalf of their organization. Nonprofits that involve their boards more deeply with fundraising and public policy advocacy will leverage this powerful resource to their organizations’ advantage.

- **Corporate Partnerships** - The TCJA cut the corporate tax rate from 35% to 21%, presenting an opportunity for nonprofits to deepen relationships and cultivate additional giving opportunities with their corporate partners.
- **New Methods of Donor Engagement** - The TCJA provides nonprofits with an opportunity to experiment with new and creative methods of engaging with donors. In the November 2017 edition of Commonwealth Insights, MNN found that donors of all ages are looking for new ways to give outside traditional models.
- **Planned Giving Programs** - Monthly, yearly, and planned giving programs will become increasingly important. They can help spread out the cost of giving for donors for whom the cost of giving will increase, and they keep donors consistently engaged with an organization throughout the year.

V. Conclusion

The TCJA will significantly alter the policy and fundraising landscapes for the nonprofit sector. But every challenge brings with it an opportunity. Nonprofits throughout the Commonwealth should prepare proactively for the changes ahead, with an emphasis on revitalizing their advocacy and fundraising operations. The nonprofit sector has proven resilient over time, and will remain an engine that powers positive social change throughout communities in Massachusetts.



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About the Massachusetts Nonprofit Network

MNN is the only statewide organization that brings together nonprofits, funders, business leaders, and elected officials to strengthen nonprofits and raise the sector's voice on critical issues. The network has more than 700 nonprofit member organizations and more than 100 for-profit affiliate partners. To join visit massnonprofitnet.org/join.

This publication series is made possible by support from the Barr Foundation.

