Heinold Banwart, Ltd.
Certified Public Accountants

Third Floor
201 Clock Tower Drive
East Peoria, IL 61611-2449

Tel (309) 694-4251
Fax (309) 694-4202
Web www.hbcpas.com

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Tax Reform Alert: Charities & Donor Impact

The Tax Cuts and Jobs Act made significant changes to individual and corporate taxation by generally lowering tax rates and widening tax brackets. In addition, certain deductions were curtailed including personal itemized deductions either through their direct elimination or indirectly by increasing the standard deduction. Charities need to be aware of these changes to understand how the new tax rules might impact their operations and better accommodate donors.

Standard Deduction Increased

The standard deduction for a married taxpayer was increased to $24,000 ($26,600 if both husband and wife are over the age of 65). As a result, far fewer taxpayers will be itemizing. For individuals with little to no mortgage interest, the threshold will be more difficult to meet. Therefore, depending on other itemized deductions, principally state and local taxes (now capped at $10,000 for 2018) or charitable donations, there may be no tax benefit to making a regular cash donation to a charity.

As a result, more taxpayers may "bunch" their donations for multiple years into one year to be able to itemize and then not donate in other years at all. This may create budgeting issues if outside donations spike and then fall off; charities may have to become adept at managing cashflow.

Donor Advised Funds (DAF)

In addition, more taxpayers may make donations to donor advised funds (DAF) to accomplish the bunching. This allows for the tax deduction in the year of contribution, but the money may not be paid to charities until a later date. The taxpayer does not need to decide who the ultimate charity is at the time of contribution to obtain the tax deduction.

Care must be taken that the donor does not deduct a contribution to a DAF twice; first when the contribution is made, then second when an acknowledgement is received from the charity. Charities should consider this in their recordkeeping and year-end letters.

Qualified Charitable Distribution (QCD)

A taxpayer who is over age 70.5 and required to take money from certain retirement accounts can directly donate all or a portion of the "required minimum distribution" (RMD) to a qualified charity. As a result of this strategy, the RMD is not considered taxable income and the donation is not reported as a charitable contribution on Sch A of the personal tax return. The QCD allows the taxpayer to effectively deduct the donation by not reporting the RMD as income. Traditional IRAs, rollover IRAs, inherited IRAs, SEP, and SIMPLE plans are eligible for the QCD. However, 401(k) plans are not eligible. The QCD can be more than a taxpayer's RMD for the year, but is limited to $100,000 per taxpayer.

The funds need to be directly donated to the charity; not deposited in the donor's bank account and then paid. This will be a very common strategy employed by those individuals over age 70.5 who have little to no mortgage interest and with significant retirement monies. Charities should consider helping to educate their donors on this tax strategy.

Charitable Contribution Limits

Cash contributions for 2018 are limited to 60% of Adjusted Gross Income (AGI), up from 50% for 2017. The limit for capital gain property donations (i.e. publicly traded stock or farmland) remains at 30% of AGI. Any excess can be carried over for five years; however, the oldest donations get used last, so there can be risk of large donations going unused.

Noncash Donations

Certain types of noncash assets can be donated to charity at more favorable terms than donating cash. Gifts of long-term capital gain property (i.e. publicly traded stock and farmland) generate a donation amount equal to the appraised value of the property. The advantage to donating the appreciated asset directly as opposed to selling the asset and then donating the cash, is that the appreciation does not need to be included in income.

In addition, a farmer who donates grain to charity may save self-employment tax in addition to income tax, particularly if they do not otherwise itemize. However, donations of ordinary income type business property (such as farm equipment) are not as advantageous. The donation amount is generally the lesser of appraised value or tax basis in the asset. Many times, such business equipment will be fully depreciated; therefore, no tax deduction would be available.

Charities should understand these noncash donation rules and be willing to accept such donations subject to due diligence.

Entertainment

Another significant change for 2018 is that entertainment expenses will no longer be 50% deductible. Instead, entertainment is 100% nondeductible starting in 2018. For charities who rely on celebrities to increase attendance at fundraising events, this will mean almost certainly that a portion of the event cost will be nondeductible by the attendee. Similarly, the cost of the meal (if it can be determined) would be nondeductible, unless a business discussion occurred, in which case it becomes 50% deductible.

Fundraising Events

Charities should consider communicating to attendees more detail of the goods and services provided in these categories for a fundraising event:

- Donation (100% deductible if donor itemizes)
- Meal (0% deductible unless a business discussion can be substantiated)
- Entertainment (0% deductible)
- Advertising/Sponsorship (100% deductible as ordinary business expense)

Sponsorships where business names and logos are prominently displayed should be considered advertising and 100% deductible. Examples would be hole sponsors for golf outings and a program sponsor for a fundraiser. The cost of the meal and entertainment (ticket value) would need to be considered (subtracted off) the sponsorship to reveal the actual deductible advertising expense.

Summary

It will be increasingly important for charities to be educated on the tax implications of donations and the value of goods and services provided at fundraisers. Helping to educate and communicate these matters is a part of good stewardship of the donor base. Please contact our office to discuss these matters.