A GUIDE FOR CHARITIES AND THEIR DONORS

NAVIGATING THE NEW TAX LANDSCAPE

ACCOUNTING, AUDIT & TAX SERVICES

A GUIDE FOR CHARITIES AND THEIR DONORS TO NAVIGATE THE NEW TAX LANDSCAPE

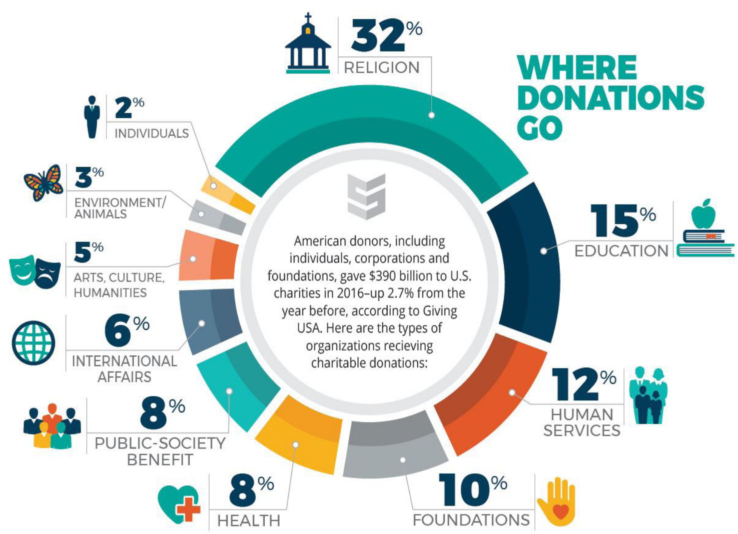
A NEW ERA OF GIVING

The historic tax reform act signed by President Trump on December 22, 2017 impacts charities and their donors alike. These new rules will require more charities to have an open conversation with their donors about their giving strategy. Let's consider these seven concepts for charities and their donors for 2018 and beyond:

1. Bunching

Many taxpayers will start to employ this strategy under the new tax regime due to the increase in the standard deduction and limitations on other itemized deductions. The standard deduction for single taxpayers increased to $12,000 while married filing jointly increased to $24,000. Experts believe this will reduce the number of itemizers from around 30% to under 10% and achieve the goal of tax simplification.

Remember that in 2018 and beyond, state and local taxes that can be deducted on Schedule A of our personal returns are capped at $10,000 per year – this includes state and local income taxes as well as real estate taxes. Additionally, all miscellaneous itemized deductions subject to the 2% of adjusted gross income limit (investment management fees, tax preparation costs, business and estate planning legal fees and employee business expenses) were eliminated from 2018 to 2025.



Credit: Kiplinger

For many taxpayers, the other significant itemized deductions reported on Schedule A included charitable contributions and mortgage interest. If the sum of their newly limited State and Local Tax (SALT) deduction, charitable contributions and mortgage interest do not exceed the 2018 standard deduction, they may employ this "bunching strategy." Generally, they will aggregate or "bunch" their charitable donations for multiple years, within a tax reporting year, to exceed the standard deduction limit in that year. Then, in the following year or years, they will limit their charitable deductions and fall well below the standard deduction.

For charities, it will become increasingly important to connect with donors to understand the intent of each gift, and whether it is intended to be for more than one year. While this may seem insignificant, the urge of expanding programs when more resources are available is always there as there is so much need. The simple question for each charity to their donor is, are you bunching or can we expect a similar gift each year?

2. Donor Advised Funds

Another concept that is growing in popularity is that of a donor advised fund. These seem to be preferred by many donors over setting up a private foundation. Historically, private foundations have been popular vehicles for creating a private fund where donations to qualified charities could be made under the control of the family establishing the foundation. The activity of a private foundation is not private, as they are required to report their activity annually. Additionally, the amount that can be donated to a private foundation is limited, as compared to a donor advised fund. Privacy and anonymity are also improved with a donor advised fund.

Charities need to be proactive in their communication with their donors, to understand when they have set up a donor advised fund and the donor's giving plan. Those donors that have established a donor advised fund may require communication on a different schedule than other donors. Maintaining careful records of each donor and their giving plan is necessary under the new tax landscape.

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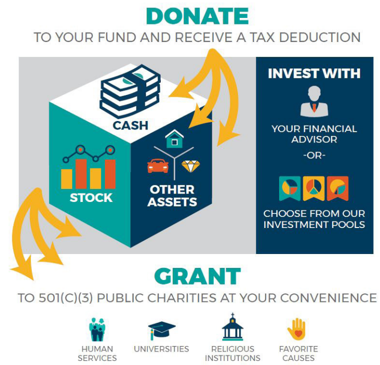
TAX PLANNING STRATEGIES FOR CHARITIES & DONORS

Charities should consider partnering with providers of donor advised funds to be a resource to donors.



Credit: Greater Kansas City Community Foundation

3. Charitable Rollovers from Individual Retirement Accounts (IRAs)

This is not a new strategy, as this was first introduced into law in 2006. This strategy should gain in popularity as less taxpayers are expected to realize the tax benefit of their charitable contributions. Thus, for taxpayers that qualify for this charitable rollover, this is a strategy that is a sure thing.

For taxpayers over 70 ½, they can contribute their Required Minimum Distribution (RMD) to a qualified public charity. Up to $100,000 of their distribution can be contributed annually. The benefit to taxpayers is that their RMD given directly to charity is not considered taxable income and does not increase their Adjusted Gross Income (AGI). In addition, taxpayers may have a state tax savings in states that do not allow itemized deductions. Alternatively, the taxpayer gets no charitable deduction, which as we know, may have been limited or eliminated due to the increased standard deduction previously mentioned.

An increase in tax liability at the federal or state and local level can result from an increase in higher income from RMDs. Additionally, Medicare premiums increase as AGI increases. Thus, a direct contribution can lower AGI and lower the tax burden.

Charities need to be proactive early in each tax year and communicate with their donor base that they accept donations directly from an IRA, as well as the tax benefits of this approach. Understanding the tax law and educating donors on options will endear donors to their charities and likely increase giving.

4. Donating Appreciated Assets

Charities need to be prepared to accept gifts of assets other than cash. Those that can will be rewarded as donors will have expanded opportunities to donate to the charity. Community foundations can also be helpful in this regard. Charities can establish a fund for their benefit at their local community foundation. In doing this, they gain the know-how and ability of the community foundation to guide donors through the process of gifting appreciated assets other than cash.

A more complex strategy employed by some business owners involves the donation of privately-held stock of the business to the donor advised fund well in advance of their exit and sale of their ownership interests. This strategy can allow the business owner to take a deduction for the fair market value of the stock at the time of the gift. Due to the complexity of this strategy for both the business owner and the donor advised fund, business owners are well advised to be planful with a team of experts.

The benefits to the donor of gifting an appreciated asset are numerous. First, it is likely that the current market value of the donated asset can be deducted on their personal return as the contribution amount and the appreciation does not need to be included as capital gain income. Another benefit to taxpayers is that they can make a sizable donation while not spending their cash reserves.

Gifts of these assets can be made directly to the charity or can be made to donor advised funds for future distribution to charities.

5. Promote Bequests

It has been well publicized that there will be a significant transfer of wealth in the coming years as Baby Boomers continue to age. Charities need to be a part of that wealth transfer and estate plan. Promoting bequests is one important strategy.

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Debra Ashton, author of *The Complete Guide to Planned Giving,* suggests that, "Once a year, the charity should do a bequest mailing to its current donors, or depending on the numbers, to people who have made a gift in the past five years making sure to include the bequest language in the letter." Such language as the below should be included on the back of your business card and in all communications with donors:

> "I give and bequeath $______ (or % of the residue of my estate or charity) whose current legal address is [insert address] or to its successor organization, to be used as (estate or charity) sees fit for its general purposes."

Further, every time a staff member or volunteer visits with a donor, he or she should leave behind the bequest language with a simple request as:

> "The next time you update your will or estate plan, would you please consider including a provision for (charity)?"

Charities should consider creating a formal bequest society and naming it after the organization's founder or major benefactor. Typically, charities hold an annual lunch or dinner to honor the society members. In addition, the charity would include the members in an annual listing when it prints the annual roster of donors.

Individuals who have included the organization in their estate plan, a will, revocable trust, or beneficiary designation in a life insurance policy or retirement plan will be members of the Society. Aston says, "It is important to acknowledge and recognize people who have made a bequest through your Society."

She said it is, "essential to get permission to include the names of society members in publications, though some will desire to remain anonymous." As you grow your bequest society, you will grow your organization's future charitable impact. Promoting bequests should be a strategy for all charities.

6. Losing the Deduction for Entertainment

Beginning in 2018, businesses can no longer deduct entertainment expenses. As we know, many charities will include some entertainment in events honoring the efforts of the charity as well as their donors.

Charities should solicit the advice of their tax advisors to assist them in designing events to mitigate the tax cost of the entertainment that might be associated with a planned charitable event. This thoughtful approach will benefit their donor base and increase their loyalty in the long-term.

7. Sponsorship vs. Charitable Donation

Business owners are benefactors of charities. Charities and the services they offer are important to a vibrant community and those in need. Businesses thrive in stronger communities.

Charitable events generally designed to raise funds are only successful if business owners are participatory and generous in their support. Business names and logos are often prominently displayed on promotional materials and event signage.

For businesses, sponsorship expense, where the benefit to the business is promotional in nature, would generally qualify as an ordinary business expense and be fully deductible. Conversely, an expense that is treated as a charitable donation may have limitations. As many businesses are set up as pass-through entities, charitable donations also pass through to the owners and are reported on their personal tax return. In the event their itemized deductions do not exceed the increased standard deduction, these business owners get no tax benefit for their charitable donation.

Charities should consult with their tax advisors to ensure they design their events with sponsorships to allow for business owners to maximize their tax benefit.

Conclusion

Charities are fighting to survive and now face the reality that many donors will lose some tax benefits from their charitable donations. This inevitably means that they will have less incentive to give. Understanding how to navigate and communicate under this new framework will certainly make a difference in the funds they collect to fulfill their mission. To learn how to navigate the new tax landscape or ramp up your planned giving efforts, contact your local Sikich advisor.