Tax Update for Nonprofits

NPO Connect – May 3, 2019

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INSIDE PUBLIC ACCOUNTING TOP 100 FIRMS 2017

990 Selected Topics

- Schedule L – Transactions with Interested Persons
  - Interested Persons:
    - Current or former director, officer or key employee
    - Creator or founder
    - Substantial contributor (more than $5K)
    - Family member of one of the above

990 Selected Topics

- Schedule L – Transactions with Interested Persons (cont'd)
  - Transactions:
    - Excess benefit transactions
    - Loans
    - Grants or other assistance
    - Business transactions
  - Excess Benefit Transaction = interested person receives greater benefit from transaction than organization
  - Business Transaction:
    - Single transaction > $10K
    - Series of transactions > $100K

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990 Selected Topics

- Schedule L – Transactions with Interested Persons (cont'd)
  - Organization must make reasonable effort to identify transactions with interested persons
    - Suggestion: distribute questionnaire to each person it believes may be an IP requesting info regarding relevant transactions, including lines for signature and date
      - May also want to include relevant portions of Schedule L instructions with the questionnaire for reference

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990 Selected Topics

- Schedule R – Related Organizations and Unrelated Partnerships (cont'd)
  - Required reporting for:
    - Disregarded entities
      - Technically not a related party as financial information is included with the organization's financial information, but still required to report on this schedule
    - Tax-exempt organizations
      - Related if:
        - Filing organization has authority to appoint or remove a majority of board members, or
        - Entities have greater than 50% common directors, officers or trustees

990 Selected Topics

- Schedule R – Related Organizations and Unrelated Partnerships (cont'd)
  - Required reporting for:
    - Partnerships or LLC's
      - Related if:
        - Filing organization of one of three or fewer owners
    - Corporations and trusts
      - Related if:
        - Beneficial owner of greater than 50%

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Non-deductible Parking – Thanks Tax Reform!

- Why would parking be nondeductible?
- Nonprofits are tax-exempt so does it matter?
- How do you compute the nondeductible amount?
- Are there ways to avoid it?

Non-deductible Parking

- Why would parking be nondeductible?
  - Sections 274(a)(4) and 512(a)(7) added by TCJA. 274(a)(4) disallows any deduction for an expense providing a qualified transportation fringe (QTF) benefit to employees. 512(a)(7) indicates that UBTI is increased by any disallowed fringe.
  - Other transportation related fringe benefits include transportation in a commuter highway vehicle, transit passes, and bicycle commuting reimbursements.

Non-deductible Parking

- Why would parking be nondeductible?
  - Section 132(f) excludes the value of a QTF from an employee's gross income up to an indexed monthly limit. For 2019, that is $265/month.
  - If the QTF exceeds the monthly limit the excess is considered income to the employee.
  - What if you don't pay for parking for your employees? There is still potentially a non-deductible portion under the TCJA.
  - Parking is considered a QTF if an employer provides parking to an employee at or near the business premises. A calculation is required for this type of parking benefit.

Non-deductible Parking

- Why does it matter to nonprofit organizations?
  - Section 512(a)(7) indicates that the disallowed expense is an increase to Unrelated Business Taxable Income.
  - If you have paid parking above the $265/month limit, it should be considered taxable income included in W-2s for your employees.

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Non-deductible Parking

- How to compute the disallowed parking deduction:
  - Parking paid to a third party:
    - Amount paid is disallowed/UBTI except to the extent included in an employee's taxable income (excess of the $265 exclusion amount).
  - Example:
    - Pay $300/month for employee parking
    - $265 excluded from employee's income; $35 included in income.
    - Deduction disallowed for $265 but the $35 is deductible (as compensation expense).

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Non-deductible Parking

- How to compute the disallowed parking deduction:
  - Parking in a facility/lot leased or owned by the taxpayer:
    - More complex calculations required. Notice 2018-99 issued in December 2018 to provide some guidance. A 4 step method is considered reasonable.
    - More guidance will be issued as we go.
    - In applying the 4 step method, you can aggregate spots from more than one parking facility in a single geographic location.

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Non-deductible Parking

- How to compute the disallowed parking deduction:
  - Any reasonable method may be used to allocate expenses, or the Notice outlines a reasonable method.
  - 4 step method:
    - Step 1 – Disallowance for reserved employee spots
    - Step 2 – Primary use test
    - Step 3 – Carve-out for parking reserved for nonemployees.
    - Step 4 – Allocation of remaining costs based on typical usage.

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Non-deductible Parking

- What expenses are considered in the calculation?
  - Repairs & maintenance including snow & ice removal, leaf removal, trash removal, cleaning, landscaping
  - Utility costs
  - Insurance
  - Property taxes
  - Interest
  - Parking lot attendant costs
  - Security
  - Rent and lease payments or a portion thereof
  - Expenses of adjacent properties (landscaping etc) are not included.
  - Depreciation is NOT an expense of providing a QTF

Non-deductible Parking

- What is NOT a reasonable method?
  - A method that uses the value of employee parking to determine expenses allocable to employee parking, or
  - A method that fails to allocate expenses to reserved employee spots.
- 4 step method allocates all expenses for reserved employee parking and typical employee usage to the disallowed deduction/UBTI amount but provides an exception for public use.

Non-deductible Parking

- 4 step method: Step 1 – Disallowance for reserved employee spots
  - Compute the cost of reserved employee parking.
  - Example: Incur total expenses related to parking facility of $10,000. There are 500 spots with 50 reserved for employees.
  - Disallowed cost is $1,000 (10,000 x 50/500). The remaining $9,000 carries over to the next step.

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Non-deductible Parking

- 4 step method: Step 2 – Primary-use test
  - Remaining parking spots are evaluated to determine the primary use of those spots.
  - Section 274(e)(7) exempts any deduction from disallowance if the expense is for an item available to the general public.
  - Primary-use test exempts the remaining spots from the calculation if the general public's typical usage of those spots during normal business hours on a typical business day exceeds 50% of the actual or estimated use of those spots.
  - For nonprofits, the normal hours are the normal hours of usage in a typical day since they may differ from a for profit's normal business hours.

Non-deductible Parking

- 4 step method: Step 2 – Primary-use test
  - Spots are treated as available to the general public even if they are typically empty or used by customers, clients, or individuals delivering goods to the taxpayer.
  - Example: We had $9,000 of costs and 450 spots remaining. If 100 of the 450 spots are determined to be used by the public (22%), the public use exception is not allowed. If 300 of the 450 (66%) are available to the general public, then the exception is available.
  - If the public use exception is available, then the $9,000 of remaining costs would be deductible/not considered UBTI.

Non-deductible Parking

- 4 step method: Step 2 – Primary-use test
  - Ambiguous areas:
    - “public” vs. “nonpublic” independent contractors
    - How to track usage if you have multiple facilities and lots.

Non-deductible Parking

- 4 step method: Step 3-Carve out for parking reserved for nonemployees
  - Only applicable if you fail the primary-use test.
  - Carve out is for reserved spaces for nonemployees such as visitors, customers, and certain owners in for-profit entities. Other rules potentially apply for owners.
  - These costs are not disallowed or includable in UBTI.
  - Using the previous example, if 50 spots of the 450 are reserved for visitors, the $1,000 of costs allocable to those spots is still deductible.

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Non-deductible Parking

- 4 step method: Step 4 – Allocation of remaining costs based on typical usage.
  - REASONABLY determine the employee use of the remaining spots during the normal hours on a typical day.
  - Assign a percentage to the employee use and multiply by the remaining costs.
  - Continued Example: Now have $8,000 of remaining costs and 400 spots left. Taxpayer identifies 350 spots used by employees during normal hours. $7,000 of the remaining costs are then disallowed ($8,000 x 350/400).

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Non-deductible Parking

- Takaways
  - Not an area to avoid, especially with the UBTI issues.
  - It may still be difficult to identify a portion of lease costs allocable to parking lots/facilities, especially if the lease agreement does not differentiate any costs for land/parking/common areas. Just ensure a reasonable allocation of rent costs is used.
  - Use of a reasonable allocation in the 4-step process should avoid any issues on audit.
  - The ability to designate more parking as available to the general public under these rules will help reduce any disallowed deduction/UBTI issues.
  - Underpayment of estimated tax penalties will be waived for certain organizations due to the new law.

Other Items in Tax Reform Impacting Nonprofits

- Excise tax on tax exempt organization executive compensation. Excise tax equal to the corporate tax rate (21%) on compensation in excess of $1 million paid to the five highest paid employees for a tax year. Excess parachute payments also are incorporated.
  - Must make a list of covered employees each year even if the tax doesn't apply so that you have it in the event it does apply in the future.
- 1.4% excise tax on certain private colleges and universities and their related organizations. Applies only to private institutions that have more than 500 tuition-paying students, have at least 50% of their tuition-paying students located in the US, and have assets of at least $500,000 per full-time student (not including assets used directly by the institution in carrying out the educational purpose).
- Section 512(a)(6) was implemented in the TCJA requiring calculation of UBTI separately for each unrelated trade or business. NOLs are then applied to trades or businesses with UBTI. The IRS will issue more guidance.

Donor Charitable Contribution Planning

- Charitable tax credits may reduce deductions
  - If cash or property is transferred as a deductible contribution **and** a tax credit received, reduce charitable deduction by amount of state or local tax credit received
  - Exceptions for:
    - Dollar-for-dollar state tax deductions
    - Credits of no more than 15% of contribution value

Donor Charitable Contribution Planning

- Charitable tax credits may reduce deductions
  - Limitation may NOT apply to businesses operating as C corporations. They are permitted to deduct the entire payment IF made with a business rather than charitable purpose (e.g. branding, community awareness, etc.)
  - In January 2019, the IRS issued Rev Proc 2019-12 which stated that businesses, such as pass through entities and sole proprietors, could not claim this exception by utilizing the business purpose rule.

Donor Charitable Contribution Planning

- Example: Charitable contribution of $1,000 and Neighborhood Assistance Credit of $650 (65%).

NONBUSINESS CONTRIBUTION			BUSINESS CONTRIBUTION	
Cash contributed	1,000		Cash contributed	1,000
Less: state tax credit	(650)		Reduction	0
§170 charitable contribution	350		§162 business expense	1,000

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Donor Charitable Contribution Planning

- Itemized deduction changes
  - Due to tax law changes that limit the state tax deduction to $10,000 and eliminate 2% miscellaneous itemized deductions, more taxpayers, especially retirees, fall into the standard deduction.
  - Standard deduction is $24,400 MFJ for 2019. If over 65 for both spouses, it is $27,000.
  - Example: Married couple with no mortgage interest gives $10,000 to charity and has $10,000 of state taxes. They don't have enough to itemize and essentially lost the benefit of their charitable deduction!

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Donor Charitable Contribution Planning

- Qualified Charitable Distributions (QCD) to the Rescue!
  - Required minimum distributions (or more) from IRA accounts can be used for charitable gifting.
  - The distribution is excluded from the taxpayer's adjusted gross income. This also helps with other calculations such as taxable Social Security Benefits.
  - Donor must be over 70.5 years old and must be from an IRA (401k, etc doesn't count).
  - Donors must inform their tax preparer that they made the QCD as the form 1099R will NOT report the amount.

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Donor Charitable Contribution Planning

- Qualified Charitable Distributions (QCD) to the Rescue!
  - IRA custodian must make the distribution to charity—cash should not go to the donor first.
  - Allowed for transfers up to $100,000 per year.
  - This is an exclusion from income, so it is not subject to any of the itemized deduction limitations on the percentage of AGI for charitable deductions.

Donor Charitable Contribution Planning

- Example:
  - Fred & Ethel are both age 72
  - 2018 AGI is $110k including $40k of RMDs from IRAs.
  - They will not itemize but take the standard deduction which was $26,600 in 2018 (both over 65)
  - Plan to make $11,000 in charitable contributions and have $10,000 of state and local taxes.
  - Under new law, itemized deductions would be $21,000 thus they would fall under the standard deduction.

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Donor Charitable Contribution Planning

	CHECKS TO CHARITY	QCD TO CHARITY	
Adjusted gross income	110,000	99,000	
Standard deduction	(26,600)	(26,600)	
Taxable income	83,400	72,400	
Change in taxable income		(11,000)	
Note that in addition to saving taxes, the Mertzs' top bracket is now 12%			
<19,050 tax rate is 10%	19,049	19,049	
19,050-77,399 tax rate is 12%	58,350	53,351	
77,400-164,999 tax rate is 22%	6,001		
	83,400	72,400	
	1,905	1,905	
	7,002	6,402	
	1,320	-	
Federal income tax	10,227	8,307	1,920

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Donor Charitable Contribution Planning

- QCDs may require certain donors to rethink how they give. Rather than giving monthly checks, they may need to do annual or quarterly to reduce the burden.
- Donors may need help understanding how to use IRA cash vs. other cash to make donations.
- Contributions of securities with appreciation is also still a great tool in order to preserve cash and exclude capital gains from income.

Questions?

Notification under the Standards of Tax Practice: tax & financial planning should be predicated on the facts at issue. This presentation is not intended to be used, and cannot be used, by you or any other person or entity for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code or any applicable state or local tax law.

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