Tax Reform in Focus
How it could affect Non-Profits

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It's been a busy year in Washington D.C. with a mixed view on accomplishments. Next on the agenda, Congress is beginning its shift (for the time being) to tax reform; lower taxes are expected to create improvements in the economy by increasing the rate of money flow (how fast it changes hands). On the surface, tax-reform has a good vibe and theoretically puts more money in consumer's pockets. Granted, personal consumption expenditures represent 70 percent of gross domestic product, but journalists should know from Econ 101 that GDP only measures the value of final output. It deliberately leaves out a big chunk of the economy—intermediate production or goods-in-process at the commodity, manufacturing, and wholesale stages—to avoid double counting. We calculated total spending (sales or receipts) in the economy at all stages to be more than double GDP (using gross business receipts compiled annually by the IRS). By this measure—which we have dubbed gross domestic expenditures, or GDE—consumption represents only about 30 percent of the economy, while business investment (including intermediate output) represents over 50 percent.

Our debate on what drives the economy (consumer or business investment) is not the focus of this article. Rather, it is tax-reform and the potential effects to non-profit boards. In my opinion, non-profit boards should be answering some not so obvious questions. Will tax reform affect my organization? How will it affect our fundraising efforts? What are the benefits and risks? What steps should we know and take? Many directors and boards will ignore these looming pitfalls. However, concerns are warranted and the leadership of non-profits are bound by a fiduciary duty to manage non-profit organizations "prudently," which means taking into account and responding to reasonably foreseeable risks. Until now, tax reform has been nothing more than political posturing and a way to garner attention. What has long been conjecture may soon become law. Now that we have your attention, let's consider the possible outcome for non-profits if tax reform becomes reality.

First, let's take a minute to consider the context of tax reform. Basically, it is supposed to "close loopholes" and redirect the resulting free cash flow. Additionally, lowering individual and corporate tax rates, doubling the standard deduction and eliminating estate tax ostensibly provides a major long term boost to the economy. This professed incentive to consumers and businesses is indubitably a great way to spark economic growth and increase our GDP without the need for more intervention by the Federal Reserve, also known as quantitative easing. This lower tax backdrop also provides additional runway for the Fed to normalize interest rates and unload its hefty balance sheet. That opens yet another discussion about reducing the enormous debt in the U.S. which we will save for later. When it comes to tax reform, most will agree that free cash flow drives consumer spending and saving. This in turn drives business and that drives GDP.

Now that you have a grasp on tax reform, let's get back to the potential effect on non-profit organizations. Fundamentally, tax reform reduces charitable contribution deductions which (possibly) results in fewer contributions to charitable organizations. Today, approximately one third of tax payers can claim charitable deductions using the itemization method. However, under tax reform, a doubling of the standard deduction will immediately reduce the number of taxpayers who itemize to about 5 percent. Since individuals provide approximately 75% of charitable donations (approximately $200 billion per year), the loss of charitable deductions to 25% of taxpayers can spell trouble for thousands of non-profit organizations. Rounding out the possible re-

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straints on charitable giving, the estate tax should not be ignored. Eliminating this confiscatory tax obviously reduces the incentive to make charitable bequests. Why? Simple, charitable giving is a strategic (and easy) way to offset estate taxes. Tax cuts will provide some undisputable benefits to the U.S. economy. However, with the good comes the bad, and charities could be adversely affected by tax reform and it may not stop with the basics.

Beyond the fundamentals of tax reform, a number of loopholes exist that Congress may try to eliminate in the upcoming tax reform. For example, limiting the deduction for gifts of highly appreciated property to basis rather than fair market value; eliminating tax-exempt bond financing; preventing the losses from one unrelated trade or business to be used to offset the income from another unrelated trade or business; taxing royalties from the licensing of an organization's name or logo; taxing corporate sponsorship payments; requiring donor advised funds to pay out 100 percent of amounts contributed within five years of receipt; eliminating Type II and Type III supporting organizations; and a host of other proposals. These proposals, if included in tax reform, would likely have an adverse effect on every charitable organization. We cannot know how far Washington will go on loopholes until it is revealed in the tax reform bill.

My suppositions of tax reform and the affects it will have on individuals, corporations and non-profits is subject to capricious politicians and the unpredictable Federal Reserve. Nevertheless, tax reform is not going away anytime soon and some form of this economic energizer will likely be passed. Of course, lowering revenues via tax cuts must be recovered though other sources. For example, the so-called border adjustment tax (BAT) which is a consumption tax could purportedly create upwards of $1 trillion annually. Because the BAT affects domestic companies bringing foreign goods into the U.S. for resale, BAT should not be a foregone conclusion and nether should tax reform in general. Nevertheless, nonprofit Boards and Directors should not disregard the feasibility of tax reform and the affects it could have on their respective organizations. Should the risks come to fruition, non-profits will be better prepared if they begin assessing the implications of tax reform.

How likely is tax reform? President Trump's team is working with House and Senate leaders to gain nonpartisan support of what should be unveiled by early fall. Both sides agree that such reform is necessary and they seem to be making progress on the impending draft. If these cagey meetings result in mutual agreement, the finished product could move swiftly through the voting process. From our view, we expect resolution on this massive overhaul by year-end 2017.

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