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Not-for-profit Update

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Learning Objective

The learning objectives for this discussion are to:

- Identify the impact of tax reform on not-for-profit organizations
- Describe strategies to address tax law changes
- Identify audit pronouncements affecting not-for-profit entities

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Tax reform. It's Here!

- Passed by both the House and the Senate
- Signed into law by President Trump – December 22nd
- Provisions effective for tax years beginning after December 31, 2017 (unless otherwise noted)
- Many proposals affecting NFP left out of final legislation
- Planning opportunities exist

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Impact: More tax to be paid

Unrelated Business Income

What's out, what's in, what changes?

UBI – what did NOT make it?

- Elimination of research exemption unless data is freely available to the public
- Licensing of an organization’s name or logo considered UBTI

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UBI – new rules

- Increase in UBI by amount of certain fringe benefits provided to employees:
  - qualified transportation fringe benefits
  - parking
  - on-premises health facilities

- "Bucketing" of activities
  - Losses of one unrelated activity can't be used to offset gains of another
  - NOLs follow same approach beginning next tax year

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UBI – new corporate tax rules

- 21% flat tax rate
- Changes to Net Operating Loss rules
  - infinite carryforward but no carryback
  - can only utilize up to 80% of taxable income
  - effective for losses with tax years beginning 1/1/18
- Repeal of Alternative Minimum Tax
- Repeal of Domestic Production Activity Deduction
- Foreign tax credit changes in deduction method
- Changes in depreciation methods for certain property

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Impact: Increased cost of hiring, retaining employees

Employee Benefits and Compensation

Removal of old exclusions, new taxes imposed

Compensation and benefit provisions – what did NOT make it?

- Repeal of educational assistance benefits
- Limitations and taxation of housing benefits
- Removal of adoption assistance benefits
- Repeal of dependent care assistance exclusion
- Various changes to qualified retirement plan rules, such as lowering the permissible age for in-service distributions and making larger amounts available for hardship distributions
- Changes to intermediate sanctions rules
- Repeal of the employer-provided child care credit
- Repeal of the work opportunity tax credit

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Compensation paid by tax-exempt organizations – new Sec. 4960

- Organizations to pay a 21% excise tax on compensation paid to a covered employee in excess of $1 million for the year
  - Effective for amounts paid after Dec. 31, 2017
- Covered employee is one of the five highest paid employees in any tax year beginning after Dec. 31, 2016
- Once a covered employee, always a covered employee
- Organization pays a separate 21% excise tax on excess parachute payments to a covered employee
  - Parachute payments are payments made on account of termination of employment (e.g., severance, nonqualified deferred compensation)
  - Applies if payments equal or exceed three times base amount
    - Base amount is average of compensation for prior five years
  - If three times test satisfied, amount subject to excise tax is total payments less 1 times base amount

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Employee achievement awards – Sec. 74 and 274

- The bill creates a new category related to employee achievement awards entitled “tangible personal property.” Employees will not be able to exclude from taxable income cash, cash equivalents, gift cards, gift certificates, vacations, meals, lodging or tickets to theater or sporting events, stock, bonds, and other securities.

- Effective for amounts paid or incurred after Dec. 31, 2017

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Employer-paid moving expenses – Sec. 132(a)(6)

The bill suspends the exclusion from gross income for qualified moving expense reimbursements for tax years beginning after Dec. 31, 2017 and before Jan.1, 2026

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Transportation fringe benefits – Sec. 132

- The bill disallows deductions for expenses associated with providing any qualified transportation fringe to employees (i.e., commuting via mass transit, parking, and bicycle costs), and except for ensuring employee safety, any expense incurred for providing transportation (or any payment or reimbursement) for commuting between the employee's residence and the place of employment
- Since the deduction is disallowed, it would be considered UBI, as discussed, if the benefit is given
- Effective for amounts paid after Dec. 31, 2017

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Rollovers of plan loan offsets – Sec. 402(c)(3)

- The bill gives an employee who has taken a plan loan until the due date for filing the employee's tax return for that year (including extensions) to repay the loan or contribute the loan balance to an IRA to avoid having the loan amount treated as a taxable distribution. The old provision was 60 days.

  Rule applies to employees whose plans terminate or who separate from employment while having a plan loan outstanding.

- Effective after Dec. 31, 2017

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Affordable Care Act individual mandate - Sec. 5000(a)

- The bill reduces the amount of the individual shared responsibility payment enacted as part of the Affordable Care Act ("the individual mandate") to zero.
- Applicable to months beginning after Dec. 31, 2018

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Impact: Loss of tax benefits for giving makes it harder to raise money

Potential Decline in Charitable Giving

Individual provisions with indirect affect on sector

Individual tax deductions
Schedule A

- State and Local Tax – limit of $10,000 of sales/property/local income taxes*
- Medical Expense deduction – reduce floor to 7.5% from 10% - *2017 and 2018 only*
- Suspend Moving Expense deduction*
- Suspends all miscellaneous deductions subject to 2% floor*
- Removes overall limitation on itemized deductions*
- Mortgage interest deduction limited to mortgages up to $750,000 (down from $1M) on debt incurred after 12/15/17*

* ***Unless otherwise noted provisions expire after 2025***

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Individual tax deductions

- Increase in Standard Deduction to $12,000 Single / $24,000 Joint (indexed for inflation) - will reduce taxpayers who itemize (complete Schedule A) from 30% to potentially less than 10%. *Provision expires after 2025*.

- Taxpayers allowed to offset up to 60% of Adjusted Gross Income with Charitable Cash Contributions; Up from 50% - expires after 2025

- Athletic Event Seating Rights – Repeal the 80% charitable deduction if the taxpayer receives in return the right to purchase tickets or seating to an athletic event

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Estate Tax

Double Individual Exemption to $10,000,000 (inflation adjusted) on estates and gifts – expires after 2025

- ***Will reduce number of tax payers who need to utilize charitable giving to reduce or eliminate estate tax***

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Impact: Potential new taxes, some with retroactive reach

International Tax Changes

Provisions NFPs need to understand

Transition tax on unrepatriated income

Institutions with certain foreign investments may be impacted by a one-time transition tax on unremitted foreign earnings.

- Generally applies to U.S. persons that hold "Specified Foreign Corporations":
  - CFCs; or
  - any foreign corporation with respect to which a domestic corporation holds at least 10%
- Unremitted foreign earnings are taxed at the following rates:
  - 15.5% to the extent such earnings are allocable to cash or cash equivalents
  - 8% for remainder
- Calculation done in aggregate, losses at one entity may offset income at another
- Taxpayers can elect to pay transition tax over 8 years on a graduated basis

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Base Erosion and Anti Abuse Tax (BEAT)

- Beginning in 2018, U.S. corporations that make excessive "base erosion payments" (BEPs) will be subject to a 10% minimum tax (5% for 2018 and 12.5% for years after 2025) on modified taxable income (computed without regard for certain BEPs and NOLs attributable to BEPs) if the U.S. corporations have both:

  - $500 million in average gross receipts (of U.S. corp. or branch) over 3 years, and
  - a base erosion percentage (a ratio of base erosion deductions compared to total deductions) of 3% or higher for the taxable year

- BEPs are generally amounts paid or accrued to a foreign-related party (related party is broadly defined) which results in a deduction (including depreciation and amortization)

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Dividends received deduction (DRD)

- Provides a 100% DRD to domestic corporations for foreign-source dividends received from 10%-or-more owned foreign corporations

- Includes a 365-day holding period

- Expands the exemption by also allowing a DRD on certain deemed income inclusions resulting from the disposition of lower-tier controlled foreign corporations

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Global intangible low-taxed income (GILTI)

- GILTI is the excess of the CFCs' aggregated net tested income over its "net deemed tangible income return" (i.e., routine return).
- Domestic corps can obtain a deduction equal to 50% of the GILTI inclusion (subject to TI limits).
- Applies to tested income of a CFC. Tested income is gross income without regard to certain exceptions (less allocable deductions) :
    1. the corporation's ECI;
    2. subpart F income;
    3. income excluded under high-tax exception;
    4. any dividend received from a related person; and
    5. certain foreign oil and gas related income, over deductions allocable to such gross income

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Deduction for foreign-derived intangible income

The law provides an incentive for domestic corporations that earn foreign intangible income (includes, sales, leases, licenses and services).

- Allows a deduction of 37.5% of the lesser of
    1. the sum of its foreign-derived intangible income (FDII), or
    2. its taxable income, determined without regard to this law
- Results in a 13.125% effective tax rate on excess returns on foreign sales and services
- Complex set of definitional rules
- The deduction for foreign-derived intangible income is reduced from 37.5% to 21.875% for taxable years beginning after December 31, 2025

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Final Thoughts

Planning the way forward

Tax planning considerations

- Higher likelihood of tax liability from profitable unrelated business activity
- Budget for increased costs of employee benefits and consider alternative offerings
- Consider changes in development efforts to retain donors
- Review international operations and investments to determine tax impact
- Certain colleges - set up reserve for excise tax on net investment income
- Impact on financial reporting and disclosure

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Accounting Standards Update

Implementations of pronouncements

ASU 2016-14: Presentation of Financial Statements of Not-for-Profit Entities

Summary	Potential impact
Main provisions: Final Standard issued August 2016 **Net Asset Classification scheme, including:** • Two classes of net assets – with and without donor-imposed restrictions • Placed-in-service treatment for expiration and release of capital restrictions; eliminates "bleeding in" or releasing over life of asset in absence of explicit donor restrictions **Underwater endowments** • Shown as reduction in net assets with donor restrictions • Disclosures include aggregate amounts underwater, aggregate original gift amount, fair value and organization policy to spend from such funds **Expenses, including:** • Expenses by nature and an analysis of expenses by function and nature in a single location • Netting of external and direct internal investment expenses against investment return • Disclosure of netted investment expenses requirement eliminated • Disclosures about methods used to allocate costs between program and support functions	Because of the extensive changes in the new guidance, colleges and universities that report as NFPs should identify the areas where changes in guidance have created the need for changes in system reporting, as well as data gathering for information not currently tracked in a system. Some information might require coordination with outside parties (e.g., related to investment expenses) as well as developing estimates to be used for reporting new information. Management should consider educating key users of the financial statements on the changes so that decision-making based on financial statements continues to be effective and timely.

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ASU 2016-14: Presentation of Financial Statements of Not-for-Profit Entities – continued

Summary	Potential impact
Operation Measures: • Disclosures required for entities that use an operating measure include governing board designations, appropriations and similar actions within that measure • Required to disaggregate these items and describe them by type, either on the face of the financial statements or in the notes **Improving disclosures of information useful in assessing liquidity:** • Quantitative disclosures: information that communicates the availability of an NFP's current financial assets at the balance sheet date to meet cash needs for general expenditures within one year of the reporting date (on the face and/or in the notes) • Qualitative disclosures: information on how an NFP manages its liquid available resources and its liquidity risk (in the notes) **Statement of Cash Flows:** • Option to use either direct or indirect method remains • Eliminates the requirement to present a reconciliation to the indirect method when using the direct method, although an entity is permitted to do so **Effective date and transition:** • Effective for fiscal years beginning after December 15, 2017 (year ending 6/30/19 for most institutions) • Early adoption is permitted, but all provisions of standard must be adopted at once • Retrospective application is required for NFPs presenting comparative statements. Liquidity and expense analysis are permitted to be presented for the current year only	Actions the University should consider now: Make new policy elections where required (for example, direct v. indirect cash flows, presentation of functional expenses in notes as separate statement or within statement of activities) Decide on early adoption Begin process of retrospectively adjusting comparative periods prior to year of adoption

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Revenue from Contracts with Customers (Topic 606)

Summary (ASU 2014-09 amended by ASU 2015-14)

- New revenue standard ASC Topic 606 is a joint effort by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB). The new standard shifts from a rules based approach under ASC 605 to a principles based approach under ASC 606, with the objective of recognizing revenue in a manner that depicts the transfer of promised goods or services to the customer in an amount that reflects the consideration to which the entity expect to be entitled in exchange for those goods or services.

- The new model contains five steps: (1) Identify the contract (2) Identify the performance obligations (3) Determine the transaction price (4) Allocate the transaction price (5) Recognize revenue.

- ASU 2014-09 was amended by ASU 2015-14 to delay the effective date. Nonpublic entities must adopt for fiscal years beginning after 12/15/18. For entities with a 6/30 year end, this means the new standard must be adopted for the fiscal year beginning July 1, 2019. Early adoption is permitted, subject to limitations.

- Transition requires the application of one of two methods:
  - Full retrospective – Restate FY17 and FY18 under the new GAAP (with option to elect certain practical expedients).
  - Modified retrospective – Apply retrospectively and recognize a cumulative effect adjustment to beginning net assets in the period of adoption (with option to apply retrospectively to only contracts that are not completed at the date of initial application).

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Revenue from Contracts with Customers (Topic 606) – current industry updates

Summary

- The AICPA Not-for-Profit Entities Revenue Recognition Task Force identified potential implementation issues and is in various stages of finalizing clarified guidance. Clarifications expected to impact higher education entities are:
  - *Tuition and housing revenue* – discussion of transaction price and when to recognize revenue – guidance finalized and included in the AICPA Guide *Revenue Recognition.*
  - *Contributions* - the guidance specifically excludes accounting for contributions from its scope – guidance finalized and included in the AICPA Guide *Revenue Recognition.*
  - *Grants* – this issue has been referred to the FASB, focus relates to the considerations of exchange vs. non-exchange and whether the terms include conditions vs. restrictions, and how those decisions drive the related accounting recognition and presentation guidance.
  - *Transactions that are part contribution and part exchange* – Clarified guidance for transactions that may be in part a contribution and in part an exchange transaction including membership dues, bargain purchases, certain grants, naming opportunities, and donor status transactions - guidance finalized and included in the AICPA Guide *Revenue Recognition.*
  - *Subscriptions & membership dues* – this issue will discuss how NFP organizations should account for membership dues, life-time membership dues, subscription revenue and life-time subscriptions – the due date for comment letters was February 1, 2018

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FASB Project Update: Revenue Recognition of Grants and Contracts by Not-for-Profit Entities

Summary of proposed update

- On August 3, 2017, the FASB issued Proposed Accounting Standards Update, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. The due date for comment letters was November 1, 2017.
- The objective of this project is to improve and clarify existing guidance on revenue recognition of grants and contracts by not-for-profit entities and would apply to both contributions received by a recipient and contributions made by a service provider. The amendments in this proposed Update would clarify and improve current guidance about the following:
    - Whether a transfer of assets is an exchange transaction or a contribution and clarify how an entity determines whether a resource provider is participating in an exchange transaction by evaluating whether the resource provider is receiving commensurate value in return for the resources transferred.
    - Amendments would require that an entity determine whether a contribution is conditional on the basis of whether an agreement includes a barrier that must be overcome and either a right of return of assets transferred or a right of release of a promisor's obligation to transfer assets.
- Proposed guidance would provide a more robust framework to determine when a transaction should be accounted for as a contribution under ASC 985-605 or as an exchange transaction under ASC 606 and help reduce diversity in practice and ease the application of judgment.
- Could result in more grants and contracts being accounted for as contributions (often conditional contributions) than under current GAAP. Recipients of conditional promises to give would be required to comply with current disclosure requirements in paragraph ASC 958-310-50-4.

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Questions?

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