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Fiscal Cliff Notes

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At Cover & Rossiter, we don't care how much Jessica Simpson weighs, we don't know Gangnam from Gingham, we don't know boo about "Honey Boo Boo," we don't keep up with the Kardashians, and, after seeing Justin Beiber on New Year's Eve, my only lasting thought was "What's with those pants?" But we do follow the latest changes to the tax code.

If there was an award for the most overused cliché of 2012, the "Fiscal Cliff" would win. The Cliff was intended as an artificial crisis to spur Congress and the President into action to reduce the federal deficit. But just as our elected officials can create artificial crises, they can postpone them. The American Taxpayer Relief Act, which passed in the wake of the initial "Cliff," is a stop-gap measure that includes some significant changes to the tax code about which all nonprofits should be aware. Since the reduction of the employee portion of the Social Security tax from 6.2% to 4.2% was not extended, *all* workers will by now have an additional 2% taken out of their gross pay. There is a bit of irony to calling a law which effectively raises the taxes on all workers the "American Taxpayers Relief Act." I suppose we should count our blessings that they didn't work in a tortured acronym as well – how about the "Senators And Representatives Can't Agree So Much" Act (SARCASM)?

The Fate of the Charitable Contribution Deduction

After the release of the Simpson-Bowles report, there was widespread concern regarding the future of the charitable contribution deduction. The 2010 report called for a vast reduction in the tax benefit of the deduction by replacing it with a very limited credit. The good news is that the deduction was not fundamentally changed, although it has been indirectly altered.

After a hiatus, the "Pease" limitation is back. This will limit all itemized deductions – including the charitable deduction - by 3% for every dollar above a stated income threshold ($300,000 for married couples for 2013). For example, let's assume a couple with $500,000 in taxable income donates $20,000. The Pease limitation would reduce the $20,000 by $6,000 [($500,000 - $300,000) x 3%] for an effective deduction of $14,000. The limit is itself limited to 80% of the deduction, meaning that if the same couple had only donated $5,000, they would still get to claim a $1,000 deduction (since $6,000 is greater than $5,000, the limit would be limited to $4,000 ($5,000 x 80%) leaving $1,000 to claim).

In some quirky situations, the charitable deduction could actually be worth *more* to the donor in 2013 than it was in 2012. If the same donor above gave $110,000 to charity, the Pease limitation would leave $104,000 to deduct. But since the top tax rate has changed to 39.6% from 35% for incomes over $450,000, the economic benefit to the donor would actually be greater (all other things being equal). Obviously, this

is a simplistic example and not intended to represent tax advice, but it serves to illustrate that the charitable deduction has not changed dramatically from 2012 and prior rules.

At the end of the day, donors do not give for strictly economic reasons. If that was true, they would most likely just keep their money in their pocket, pay the tax due and be farther ahead financially than gifting the money regardless of the tax break. The impact of the overall economy does far more to dictate charitable giving than changes to the tax treatment of the donation.

Other Nonprofit Tax Issues for the New Year

Direct rollover IRA contributions survived for another year as did gifts of conservation easements. The same strict rules and caveats still apply to both of those. Favorable tax treatment of contributions of book inventories and used computer equipment, however, were not allowed to continue.

The estate tax changed slightly – the top rate went from 35 to 40%, but there is a permanent $5,000,000 exclusion per person which can be transferred between spouses to create a joint $10,000,000 exclusion before the first dollar of federal estate tax kicks in. There was some concern that doing away with the estate tax altogether – as proposed during the presidential campaign – would severely curtail planned giving efforts at many charities.

Anyone who is involved in any capacity with a non-functionally integrated Type III Supporting Organization (hopefully you know who you are) received a bit of a Christmas present. IRS final rules defining the required distributions for those organizations were issued, but at 3.5% of assets instead of the 5% they had previously advertised. The requirement will be effective for 2014 based on 2013 asset values.

If your organization has questions about any existing or new tax laws for nonprofits, please contact Pete Kennedy, or any other member of our Nonprofit Practice team, at Cover & Rossiter at (302) 656-6632.

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