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PREPARING FOR YOUR AUDIT & TAX REFORM CHANGES

Steve Heere, Partner – Audit Services
Robin Ryan, Senior Manager – Audit Services
Jason Hardy, Manager – Audit Services
Rick Dynoske, Senior Manager – Tax Services

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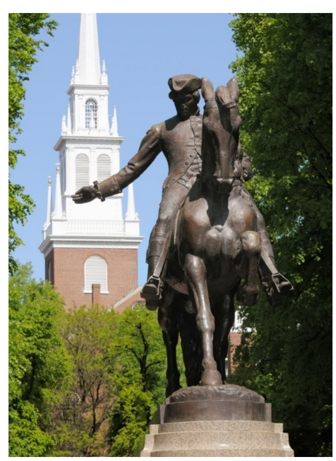
The Auditors Are Coming!
The Auditors Are Coming!

GETTING READY FOR YOUR ANNUAL AUDIT



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PREPARING FOR YOUR AUDIT

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GOALS FOR AN EFFICIENT & EFFECTIVE AUDIT PROCESS

- **Collaborative effort**
  - ***Management, board/committee, and auditor***
- **Reduction of cost, time and stress**
- **Use an audit to your advantage**
- **View audit as an investment in the organization**
- **Improved audit outcomes**

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DOES OUR ORGANIZATION REQUIRE AN AUDIT?

- **Federal Requirement**
  - ***$750,000 in federal expenditures***
- **State Requirement (Pennsylvania)**
  - ***New solicitation thresholds for 2018:***
    - $750,000 or greater requires audit
    - $250,000 to $749,999 requires review or greater
    - $100,000 to $249,999 requires compilation or greater
    - Less than $100,000 requires internally prepared or greater

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OTHER AUDIT REQUIREMENTS

- **Grant/donor requirement**
- **Debt/bank requirement**
- **Bylaws or corporate practice**

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ROLE OF FINANCE OR AUDIT COMMITTEE

- **Selection of independent accounting firm**
- **Oversight of audit process**
- **Assumes overall responsibility for audit process and implementation of changes recommended as a result of the audit process**

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ROLE OF MANAGEMENT

- **Day-to-day accounting function and month and year-end closing**
- **Primary interaction with auditors**

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PLANNING COMMUNICATION

- **Planning meeting**
  - ***Scope and timing***
  - ***Current year developments***
  - ***Discussion of risks and key areas***

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ENGAGEMENT LETTER

- **Scope**
- **Expectations and responsibilities**
- **Timing and logistics**
- **Fee**
- **Delivery**
- **REVIEW CAREFULLY**

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COMMUNICATION DURING THE YEAR & AUDIT PROCESS

- **Frequency is important**
- **Be open and candid about changes, concerns and areas of difficulty**
- **Ask questions to understand process and procedures**
- **Inquire about impending changes in accounting requirements**

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BEST PRACTICES TO PREPARE FOR AN AUDIT

- **Select an individual to be primary contact & delegate**
- **Implement strong monthly closing and analysis process**
- **Prepare a pre-audit checklist**
- **Document internal controls and policies**
  - ***Controls write-up will assist in understanding the organization***
  - ***Assists in determining risk and testing approach***
  - ***Update regularly and verify compliance***

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WHAT WILL THE AUDITORS REQUEST?

- **Corporation/organization documents and tax exempt letters**
- **Policies and procedures**
- **Information regarding internal controls**
- **Internal financial statements**
- **Board minutes**
- **Grant letters and funding contracts**
- **Debt and lease agreements**
- **Other**

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POINTS TO REMEMBER

- **Plan ahead**
  – ***"Audit" throughout the year and observe internal controls***
  – ***Learn from the past and set expectations***
  – ***Ask questions early and often***
- **Be available during fieldwork**
- **Evaluate results**

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AUDIT FIELDWORK

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FIELDWORK

- **What people generally think of as “the audit”**
- **Interaction with an engagement team**
- **Requests for documentation including invoices, checks and statements**
- **Inquiries**

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CLIENT CONCERNS

- **Time – audits take time**
- **Obtrusiveness**
- **Accuracy – to the penny**
- **Training new auditors**

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EFFECTIVE FIELDWORK

- **Starts with planning**
- **Communication – establish lines of communication up front**
- **Expectations**
- **Respect**
- **Flexibility as necessary**

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WHO IS INVOLVED?

- **Collaborative process between the audit team and management/staff of the client**
  - *Client side – CEO/Executive Director, CFO/Controller, members of the accounting staff*
  - *Audit side – Partner, Manager, Senior/In-Charge, staff accountant(s)*
- **Those interactions may vary based on the size/nature of the organization**

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THINGS TO THINK ABOUT

- **Through whom should the audit team funnel requests for information or questions?**
- **How would you like questions or requested addressed – ongoing or at certain points in the day?**
- **Preferred means of communication – email, telephone, in-person, other?**

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TIMING OF FIELDWORK

- **At the convenience of the client – usually**
- **Interim fieldwork**
- **Final fieldwork**
- **How long will it take?**

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THINGS TO THINK ABOUT

- **When can you be ready?** ***(G/L balances, acct reconciliations)***
- **Unusual or complex/situations** ***(how much time will be needed to address)***
- **Staffing –** ***will the necessary staff members be available during fieldwork to answer questions or provide documentation***
- **Target completion date –** ***board reporting, IRS or county reporting requirements***

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WHERE WILL WE PUT THE AUDITORS?

- Traditionally, audits were done at the offices of the client
- Audit planning allows for the most effective use of resources including space
- Technology has allowed for alternative approaches to audits
- Secure transmission of audit documentation via client portals
- Cloud-based software
- On-location interaction allows auditors to get a better appreciation of the staff/programs

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THINGS TO THINK ABOUT

- Physical constraints related to space and time
- Access to technology options
- Concerns related to privacy
- Relationships

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WHAT INFORMATION WILL BE NEEDED?

- Key component of planning
- Document request list
- Trial balance (CY and PY if a first-year engagement)
- Internal financial statements
- Access to G/L detail
- Permanent file documentation

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THINGS TO THINK ABOUT

- Significant assets/liabilities
- Sources of revenue/expenses
- People costs
- Single-audit considerations
- Risk
- Reporting requirements

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COMMON REQUESTS

- Bank statements and reconciliations
- Accounts/pledge receivables aging/detail
- Inventory support
- Investment support
- Fixed asset schedules
- Accounts payable aging

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THINGS TO THINK ABOUT

- Has anything changed from the previous year that impacted the organization's financial position?
- Were there any unusual or complex situations that occurred throughout the year?
- New debt agreements or modifications of previous debt agreements
- Long-term agreements
- Grant restrictions

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HOW DO THE AUDITORS AUDIT?

- **Assess areas of risk based upon planning procedures in order to make audit selections**
- **Formulate expectations regarding account balances or changes in account balances based on information obtained during planning**
- **Evaluate the population of transactions related to an account balance or category in order to request substantive documentation (invoices/checks/deposits) and test those transactions – often a dual purpose – to agree a balance and ensure transactions are recorded appropriately**

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HOW DO THE AUDITORS AUDIT? (continued)

- **Review documentation (preferably from outside sources) in order to substantiate account balances (bank statements/ reconciliations, vendor invoices, loan statements)**
- **Evaluate the roll forward of information from one year to the next, including fixed asset info, debt and net assets**
- **Analytically assess account changes and inquire/request support for fluctuations that are unexpected**
- **Conduct inquiries of management/staff regarding account fluctuations, fraud and other items of note**

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HOW DO THE AUDITORS AUDIT? (continued)

- **Assess materiality of account adjustments and discuss appropriate treatment with management (record entry or record on the schedule of unadjusted differences)**

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IN SUMMARY

- **While there is a commonality to the audit process, there is no "one-size-fits-all" – the procedures and inquiries are tailored to the organization**
- **Advance preparation by the client allows for a more organized and effective audit**
- **Questions throughout the year are welcome**

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IN SUMMARY (continued)

- **The more the audit team understands the organization and the people that make up the organization, the more effective and efficient the process will be**
  - ***That allows the audit team to understand how and why transactions are recorded in a certain manner***
- **If there are audit areas that have traditionally caused you grief, let the audit team know in advance so a plan can be worked out to prevent delays in the audit process**

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CONCLUDING THE AUDIT PROCESS

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CONCLUDING THE AUDIT PROCESS

- **Preparing the financial statements and related footnotes**
- **Preparing the governance letter and management letter**
- **Reviewing the deliverables with management and the board**
- **Reviewing any proposed adjustments or internal control comments with management**
- **Performing subsequent event and going concern evaluations**
- **Obtaining a management representation letter**

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PREPARATION OF THE FINANCIAL STATEMENTS

- **The financial statements belong to the organization**
  – ***Management is responsible for the preparation and presentation in accordance with GAAP***
  – ***However, often prepared by the auditors***
  – ***Management must still be able to accept responsibility for them***
    - Inability to do so can create potential independence issues for the auditor

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PREPARATION OF THE FINANCIAL STATEMENTS

- **Management should carefully review the financial statements**
  - ***Approval of proposed audit adjustments***
  - ***Agreement or reconciliation of line items to internal financial statements or general ledger***
  - ***Verification of amounts and other content disclosed in the footnotes***
  - ***Presentation of programs and organizational description***

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PREPARATION OF THE FINANCIAL STATEMENTS

- **Additional financial statement considerations**
  - ***Going concern***
  - ***Other significant disclosures***
  - ***May be helpful to review a comprehensive disclosure checklist***
  - ***Supplemental schedules***
  - ***Single audit and other compliance reporting***

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THE GOVERNANCE LETTER

- **Required communication to board or other appropriate governing body**
- **Draws the board's attention to significant elements of the financial statements**
  - ***Changes in accounting policies***
  - ***Significant estimates***
  - ***Sensitive disclosures***
  - ***Impact of corrected and uncorrected misstatements***

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THE GOVERNANCE LETTER

- **Also communicates any audit process difficulties or client relations matters**
  - ***Difficulties in performing the audit (delays in timing, access to documentation, numerous adjustments, etc.)***
  - ***Disagreements with management over significant accounting or financial matters***
  - ***Consultations with other accountants (opinion shopping)***

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THE MANAGEMENT LETTER

- **Communicates internal control deficiencies and other opportunities for process improvements**
- **Required communication if the auditor identifies:**
  - – *Material weaknesses in internal control*
  - – *Significant deficiencies in internal control*
- **Auditor judgment is applied in making these assessments**

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THE MANAGEMENT LETTER

- **Audit is not designed to express an opinion on internal control; deficiencies identified during the audit process**
- **Each comment should be reviewed with management**
  - – *Proper understanding of observations*
  - – *Mitigating factors*
  - – *Proposed resolution*

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THE MANAGEMENT LETTER

- **Auditor may also wish to communicate other process recommendations**
  - ***Can be formal or informal***
- **Comments should be presented to the oversight board**
  - ***The status of comments should be tracked from year to year***

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REVIEW WITH GOVERNING BODY

- **Formal meeting to present and review the financial statements, governance letter and management letter**
  - ***Board should understand all of the key elements of the financial statements***
  - ***Discuss any matters communicated in the governance and management letters***
  - ***Document approval of the reports and letters***

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FINAL PROCEDURES

- **Update of review for subsequent events or going concern matters**
  - ***Inquiries regarding new developments***
  - ***Recent internal financial information***
  - ***Updates to existing legal or other contingencies***
  - ***Going concern is now one year from date financial statements are available to be issued***

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FINAL PROCEDURES

- **Management representation letter**
  - ***Signed by those with knowledge of the applicable matters and appropriate responsibility for the financial statements***
  - ***Management has fulfilled its responsibilities regarding:***
    - Preparation and presentation of the financial statements
    - Internal controls
    - Providing all relevant information and access
    - Recording all transactions in the financial statements

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FINAL PROCEDURES

- **Management representation letter**
  - ***Specific representations regarding:***
    - Fraud
    - Litigation and claims
    - Estimates
    - Related party transactions
    - Subsequent events

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TIPS FOR A SPEEDY AUDIT WRAP-UP

- **Work towards a pre-established meeting date for review and approval of the audit**
  - ***Factor in time for management to review the information in advance***
  - ***Allow for audit evidence that may take time to obtain***
  - ***Timely responses to other audit requests***

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TIPS FOR A SPEEDY AUDIT WRAP-UP

- **Anticipate potential audit issues and address early**
  - ***Accounting uncertainties and estimates***
  - ***Complex or significant transactions***
  - ***New disclosures***
  - ***Debt covenant violations***

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TIPS FOR A SPEEDY AUDIT WRAP-UP

- **Strive for progressively improved audit results**
  - ***Minimize audit adjustments***
  - ***Address management letter comments***
  - ***Align internal financials and audited financials to facilitate management's and the board's understanding of the audit***

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TIPS FOR A SPEEDY AUDIT WRAP-UP

- **Prepare the Form 990 as the audit is concluding**
  - ***Presentation of the audit may be modified to better align with the Form 990***
  - ***Requests for information can be made at the same time***
  - ***Management and the board may prefer to review both the audit and the Form 990 together***

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Nothing in life is said to be certain
...except Death and Taxes

ANTICIPATED EFFECTS OF TAX REFORM

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OVERVIEW OF PRESENTATION

- **Introduction**
- **Effects on Individuals and Not-for-Profit Relationships**
  - ***Major Components***
  - ***Examples***
  - ***Percentage Limit Increase***
  - ***Repeal of College Athletic Seating Rights Payments***
  - ***Other Items***

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OVERVIEW OF PRESENTATION

- **Specific Effects on Not-for-Profit Organizations**
  - ***UBIT Computation***
  - ***UBIT Fringe Benefit Expenses***
  - ***Excise Tax on Excess Compensation***
  - ***Excise Tax on Investment Income***

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EFFECTS OF TAX REFORM ON INDIVIDUALS & NFP RELATIONSHIPS

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EFFECTS ON INDIVIDUALS AND NFP RELATIONSHIPS

- **Major Components for Individuals**
  - ***Reduced Marginal Tax Rates***
  - ***Increased Standard Deduction***
  - ***Elimination of Personal Exemptions***
  - ***Expanded Child Tax Credit***
  - ***Changes to Itemized Deductions***
  - ***Increased Thresholds/Exemptions before Application of AMT***

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EFFECTS ON INDIVIDUALS AND NFP RELATIONSHIPS

- **Reduced Marginal Tax Rates**
  - ***Pre-Tax Reform:***

    10%, 15%, 25%, 28%, 33%, 35% and 39.6%
  - ***Post-Tax Reform:***

    10%, 12%, 22%, 24%, 32%, 35% and 37%

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EFFECTS ON INDIVIDUALS AND NFP RELATIONSHIPS

- **Increased Standard Deduction**

Filing Status	As of 12/31/2017	Effective 01/01/2018
Single	$6,350	$12,000
Married Filing Joint	$12,700	$24,000
Married Filing Separately	$6,350	$12,000
Head of Household	$9,350	$18,000

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EFFECTS ON INDIVIDUALS AND NFP RELATIONSHIPS

- **Elimination of Personal Exemptions**
  - ***For 2017 taxpayers were granted a personal exemption of $4,050 per qualified child***
  - ***As of January 1, 2018, personal exemptions are eliminated, and an expanded Child Tax Credit is in effect***

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EFFECTS ON INDIVIDUALS AND NFP RELATIONSHIPS

- **Expanded Child Tax Credit**
  - ***Before tax reform, credit was $1,000 per child, with phaseouts beginning at $110,000 (married filing jointly)/$75,000 (single), reduced by $50 per each $1,000 over the applicable threshold***
  - ***The new credit provides $2,000 per child, with phaseouts beginning at $400,000 (married filing jointly)/$200,000 (all other taxpayers)***
  - ***The reduction of $50 per each $1,000 over still applies to these increased phaseout thresholds***

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EFFECTS ON INDIVIDUALS AND NFP RELATIONSHIPS

- **Changes to Itemized Deductions**
  - ***Limitation on State and Local Tax deduction – $10,000 maximum (previously, not limited)***
  - ***Elimination of Miscellaneous 2% itemized deductions***
  - ***Reduction of Mortgage Interest Limitation from Total Indebtedness from $1,000,000 to $750,000***
  - ***Elimination of Pease Limitation (previously, 3% reduction to the value of a taxpayer's itemized deduction for every $ above certain thresholds)***

Some analysts estimate that only 10% of taxpayers will itemize under TCJA

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EXAMPLE #1 – Tax Reform's Effect on Itemized Deductions

	OLD LAW	NEW LAW
Wages – Taxpayer	$ 110,000	$ 110,000
Wages – Spouse	82,000	82,000
Interest/Dividend Income	8,000	8,000
Total Income	$ 200,000	$ 200,000
Personal Exemptions (4,050*6)	24,300	-
Standard Deduction	12,700	24,000
Itemized Deductions:		
Taxes – State and Local	15,000	10,000
Mortgage Interest	8,000	8,000
Charitable Contributions	12,000	12,000
Miscellaneous 2%	500	-
Subtotal	$ 35,500	$ 30,000

	OLD LAW	NEW LAW
Total Income	$ 200,000	$ 200,000
Greater of Standard or Itemized	(35,500)	**(30,000)
Personal Exemptions	(24,300)	-
Taxable Income	$ 140,200	$ 170,000
Federal Tax Liability	26,528	29,379
Child Tax Credit	-	(8,000)
Net Federal Tax Due	$ 26,528	$ 21,379

Assumes family of four children, taxpayer and spouse.

***Despite tax reform changes, this taxpayer would still itemize.*

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EXAMPLE #2 – Tax Reform's Effect on Itemized Deductions

	OLD LAW	NEW LAW
Wages – Taxpayer	$ 60,000	$ 60,000
Wages – Spouse	39,000	39,000
Interest/Dividend Income	1,000	1,000
Total Income	$ 100,000	$ 100,000
Personal Exemptions (4,050*6)	24,300	-
Standard Deduction	12,700	24,000
Itemized Deductions:		
Taxes – State and Local	9,500	9,500
Mortgage Interest	3,500	3,500
Charitable Contributions	1,000	1,000
Subtotal	$ 14,000	$ 14,000

	OLD LAW	NEW LAW
Total Income	$ 100,000	$ 100,000
Greater of Standard or Itemized	(14,000)	**(24,000)
Personal Exemptions	(24,300)	-
Taxable Income	$ 61,700	$ 76,000
Federal Tax Liability	8,323	8,739
Child Tax Credit	(4,000)	(8,000)
Net Federal Tax Due	$ 4,323	$ 739

Assumes family of four children, taxpayer and spouse.

***No tax benefit received for charitable contributions due to taxpayer utilizing higher standard deduction in 2018.*

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EFFECTS ON INDIVIDUALS AND NFP RELATIONSHIPS

- **Charitable Contribution Percentage Limit Increase**

<u>*Up to 12/31/2017:*</u>

- The charitable contribution itemized deduction was generally limited to 50% of a taxpayer's "contribution base"

<u>*As of 01/01/2018:*</u>

- The charitable contribution itemized deduction is generally limited to <u>60%</u> of a taxpayer's "contribution base"

– ***Contribution base*** = an individual's adjusted gross income without regard to net operating loss carrybacks [§170(b)(1)(G)]

– Typically taxpayers may carry forward an unused charitable donations due to this limitation for up to 5 tax years

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EXAMPLE #3 – *Effect of 50% vs 60% AGI Limit*

	OLD LAW	NEW LAW
Wages – Taxpayer	$ 350,000	$ 350,000
Wages – Spouse	100,000	100,000
Interest/Dividend Income	25,000	25,000
Total Income	$ 475,000	$ 475,000
Personal Exemptions (4,050*6)	24,300	-
Standard Deduction	12,700	24,000
Itemized Deductions:		
Taxes – State and Local	30,000	10,000
Mortgage Interest	8,000	8,000
Charitable Contributions	250,000	250,000
AGI Limitation	237,500	285,000
Lesser of Actual or AGI Limitation	237,500	250,000
Miscellaneous 2%	500	-
Pease Limitation	(4,836)	-
Subtotal	$ 271,164	$ 268,000

	OLD LAW	NEW LAW
Total Income	$ 475,000	$ 475,000
Greater of Standard or Itemized	(271,164)	**(268,000)
Personal Exemptions	-	-
Taxable Income	$ 203,836	$ 207,000
Federal Tax Liability	45,415	42,747
Child Tax Credit	-	(4,250)
Net Federal Tax Due	$ 45,415	$ 38,497

Assumes family of four children, taxpayer and spouse; however, personal exemptions are phased out.

***Despite tax reform changes, this taxpayer would still itemize.*

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- **Repeal of College Athletic Seating Rights Payments**
  - *Old law*
    - A donor who made a charitable donation to a college or university and, in return, received the right to purchase tickets to athletic events in the institution's athletic stadium could deduct up to 80% of the payment as a charitable contribution
    - Donation cannot be for tickets themselves, but only for "right to purchase"
  - *New law*
    - Charitable contribution deduction repealed, effective 01/01/2018

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- **Other Issues – Increase to Estate Tax Exemption**
  - ***The gift and estate tax exemption was doubled from $5 million to $10 million per individual beginning in 2018 (this provision sunsets in 2026)***
  - ***This increase could reduce charitable bequests, as individuals can now bequeath larger amounts to individuals tax-free***

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- **Other Issues – Qualified Charitable Distributions**
  - ***Allows a direct reduction to the taxable portion of required minimum distributions from a IRA***
  - ***Requirements***
    - Distribution must be made on or after the date the individual beneficiary has reached age 70½
    - Distribution must be made directly by the IRA trustee to an eligible organization
    - Total qualified charitable distributions may not exceed $100,000 in a tax year *(for all individual beneficiary's IRA accounts)*

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EFFECTS ON INDIVIDUALS AND NFP RELATIONSHIPS

- **Other Issues – Qualified Charitable Distributions**
  - ***Benefits***
    - Allows taxpayers who do not itemize to receive a charitable deduction
    - Allows taxpayers more efficient donation
    - Reduces provisional income used to calculate taxable portion of Social Security benefits received
    - Effects on Adjusted Gross Income
      - Capital Gain Tax Rates
      - Net Investment Income Tax
      - Increase Medicare Premiums
      - Other Itemized Deductions and Limitations tied to AGI

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EXAMPLE #4 – *Qualified Charitable Distributions*

	W/O DIST.	WITH DIST.
Required Minimum Distribution	$ 30,000	$ 25,000
S.S. Benefits Received	25,000	25,000
Taxable Portion of S.S. Benefits	11,725	7,475
Total Income	$ 41,725	$ 32,475
Standard Deduction	12,000	12,000
Itemized Deductions:		
Taxes – State and Local	4,500	4,500
Charitable Contributions	5,000	0
Subtotal	$ 9,500	$ 4,500

	W/O DIST.	WITH DIST.
Total Income	$ 41,725	$ 32,475
Greater of Standard or Itemized	(12,000)	(12,000)
Taxable Income	$ 29,725	$ 20,475
Federal Tax Liability	3,377	2,267
Tax Savings		$ 1,110

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- **Other Issues – Universal Charitable Deduction**
  - ***Many not-for-profits lobbied for a "universal charitable deduction" to be included in the final tax reform legislation***
  - ***The universal charitable deduction would be a deduction for taxpayers donating to charities whether or not the taxpayer itemized or used the standard deduction***
  - ***Unfortunately, this provision was omitted***

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- **Other Issues – Corporate Charitable Giving**
  - ***Some analysts believe that corporate charitable giving may decrease***
  - ***Because they are now subject to lower tax rates (marginal corporate rate decreased from 35% to 21%), corporations may have less incentive to donate to charitable organizations***

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- **Other Issues – Johnson Amendment**
  - ***Preserves nonpartisanship for not-for-profit organizations***
  - ***Draft tax reform legislation would have weakened the existing law***
  - ***Some analysts believe that the removal of this amendment would place pressure on not-for-profit organizations to please certain donors/lobbyists and take away from the focus on the organization's mission***

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EFFECTS OF TAX REFORM ON NOT-FOR-PROFIT ORGANIZATIONS

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EFFECTS ON NOT-FOR-PROFIT ORGANIZATIONS

- **Unrelated Business Income**
  - ***The income must be from a trade or business regularly carried on by the organization, and***
  - ***The trade or business must not be substantially related – aside from the need of the organization for funds or the use it makes of the profits – to the organization's exercise or performance of the purpose(s) or function(s) on which its exemption is based***

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- **UBIT Computation**

Old Law:

- Unrelated Business Income = the aggregate of its gross income from all unrelated businesses, less the aggregate of the deductions allowed with respect to all such unrelated businesses
- 15% tax rate on first $50,000 of UBIT

New Law:

- Unrelated business income must be separately calculated for each unrelated business and then added together
- This requirement is in effect for all purposes, including the calculation of any net operating loss deduction(s).
- Eliminates 15% tax rate on first $50,000
- Corporate tax rates (applicable to UBIT) decreased from 35% to 21%

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EFFECTS ON NOT-FOR-PROFIT ORGANIZATIONS

- **UBIT Computation**
  - ***Previously, not-for-profits could use the losses of one unrelated business to offset the income of another unrelated business***
    - This also applied to net operating losses (NOLs) from prior tax years (which may be carried back 2 years and forward for up to 20 years)
  - ***Following tax reform, NOLs from one unrelated business may not offset the unrelated business income of another entity***
  - ***Expenses under §274 for qualified transportation fringe benefits and qualified parking may no longer be included as deductions in computing UBIT***

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EXAMPLE #5 – *UBIT Computation*

OLD LAW			
	UBIT #1	UBIT #2	COMBINED
Revenue	$ 22,000	$ 15,000	$ 37,000
(Expenses)	(15,000)	(19,000)	(34,000)
§512(b)(12) Deduction	(1,000)	(0)	(1,000)
UBIT	6,000	(4,000)	2,000
Prior-Year NOL	(0)	(2,000)	(2,000)
Net UBIT	$ 6,000	$ (6,000)	$ (0)

NEW LAW		
	UBIT #1	UBIT #2
Revenue	$ 22,000	$ 15,000
(Expenses)	(15,000)	(19,000)
§512(b)(12) Deduction	(1,000)	(0)
UBIT	6,000	(4,000)
Prior-Year NOL	(0)	(2,000)
Net UBIT	$ 6,000	$ (6,000)

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EFFECTS ON NOT-FOR-PROFIT ORGANIZATIONS

- **UBIT Fringe Benefit Expenses**

Old Law:

- Allowable as a deduction to UBIT

New Law:

- Effective for amounts paid or incurred after December 31, 2017, UBIT of an exempt organization will be increased by the nondeductible amount of certain fringe benefit expenses incurred by the organization

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- **Certain Fringe Benefits – §274**
  - ***Fringe benefits are expenses for which a deduction is not available due to §274 – specifically, these include:***
    - Any qualified transportation fringe
    - Any parking facility used in connection with qualified parking
    - Any on-premises athletic facility
    - *To the extent the amount paid or incurred is directly connected with an unrelated trade or business that is regularly carried on by the organization, such amounts <u>will not</u> increase an organization's UBIT

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EFFECTS ON NOT-FOR-PROFIT ORGANIZATIONS

- **Executive Compensation and Parachute Payments**
  - ***For-profit, general compensation rule:***
    - §162(a): Employers are allowed a deduction for reasonable compensation expenses
    - §162(m): Publicly held corporations cannot deduct compensation to a covered employee to the extent it exceeds $1,000,000

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EFFECTS ON NOT-FOR-PROFIT ORGANIZATIONS

- **Executive Compensation and Parachute Payments**
  - ***The $1,000,000 threshold is reduced by excess parachute payments that are not deductible under the "golden parachute" provisions of §280G***
  - ***Example:***
    - An individual is paid $1,000,000 and receives $200,000 excess parachute payment
    - The threshold for executive compensation is lowered to $800,000 ($1,000,000 wages less $200,000 parachute payment)

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- **Executive Compensation**
  - ***21% excise tax (new maximum corporate tax rate) on a tax-exempt organization's remuneration to highly compensated individuals***
    - Remunerations (wages) plus excess parachute payments in excess of $1,000,000 an excise tax is assessed
  - ***Remuneration does not include:***
    - Designated Roth contributions
    - Remuneration paid to licensed medical professionals (doctor, nurse, veterinarian) for performance of medical/veterinary services

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EFFECTS ON NOT-FOR-PROFIT ORGANIZATIONS

- **Excise Tax on Investment Income of Private Colleges and Universities**
  - ***Historically, only private foundations have been subject to an excise tax on the foundation's net investment income***
    - Net Investment Income: gross investment income and net capital gain less expenses paid/incurred in earning the gross investment income (interest, dividends, rents, and royalties)
    - Excise tax of 2% applied to net investment income, 1% if the private foundations made certain, qualifying charitable contributions

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- **Excise Tax on Investment Income of Private Colleges and Universities**
  - ***§4968 imposes a 1.4% excise tax on the net investment income (follows definition used for private foundations) of "certain private colleges and universities" for tax years beginning after December 31, 2018 exempt purpose***
  - ***Regulations defining when assets are "directly used" in the organization's exempt purposes have not yet been released***

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- **Excise Tax on Investment Income of Private Colleges and Universities**
  - ***§4968 definition of "certain private colleges and universities," i.e., "applicable educational institutions"***
    - Have at least 500 students during preceding tax year (of which 50% located in the United States)
      - Based on daily average of full-time students attending institution with part-time students taken into account on full-time-student-equivalent basis
    - Are private educational institutions (<u>not</u> state colleges/universities)

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- **Excise Tax on Investment Income of Private Colleges and Universities**
  - ***§4968 definition of "certain private colleges and universities," i.e., "applicable educational institutions"***
    - Have assets with an aggregate fair market value of at least $500,000 per student (as measured at the end of the preceding tax year)
      - Does not include assets used directly in carrying out the institution's exempt purpose
      - Regulations defining when assets are "directly used" in the organization's exempt purposes have not yet been released

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- **Alternative to State Tax Payments**
  - ***Some states are creating foundations or organizations for individual taxpayers to "donate" to in order to satisfy taxpayers' state income tax liabilities***
  - ***This is beneficial to individual taxpayers, since the tax reform severely limits the deduction for state and local income tax payments in 2018, but the itemized deduction for charitable contributions is expanded via the 60% adjusted gross income limitation***
  - ***PA has already adopted a similar program – contact GYF for more information about how your organization or donors may benefit***

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- **Employer Issues**
  - ***IRS Publication 15 includes updated withholding information and tables for employers***
  - ***The IRS posted an updated withholding calculator on its website: https://www.irs.gov/individuals/irs-withholding-calculator***

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QUESTIONS OR COMMENTS?

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THANK YOU FOR ATTENDING!

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