The Impact of Recent Tax Code Changes on Arts Organizations

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This paper was presented at the 2018 International Summit of the
Music & Entertainment Industry Educators Association
March 22-24, 2018

https://doi.org/10.25101/18.21

Abstract

The recent changes in the tax code will have an impact on donations to charitable organizations, including 501c3 arts organizations in the near future, though the exact impact is unknown. This facet of arts management will be necessary to include and/or revise in course curricula. It is imperative to understand how these changes may affect individual giving, as it is a known fact that individuals provide the largest pool of support to arts organizations. Specifically, this paper will provide a better understanding of the tax code through the lens of the National Council of Nonprofits and other tax policy centers so an arts organization can better plan for the future in terms of strategizing income from ticket/event sales, grant and foundation giving, business sponsorships, and individual donations. The author will also glean strategies for maximizing potentially shrinking individual donations.

Keywords: Tax Cuts and Jobs Act (TCJA), charitable giving, arts organizations, tax deductions

Introduction

This paper introduces the new Tax Cuts and Jobs Act (TCJA), H.R. 1 signed into law December 17, 2017. In order to highlight changes and their impacts on charitable nonprofits under the new tax law, the existing tax law pertaining to charitable giving donations is also reviewed. Arts organizations are under the umbrella of charitable nonprofits and designated as 501c3 organizations. After the impact of charitable giving due to the TCJA is discussed, ideas both internal and external to organizations will be proposed for strategizing for the future.

Existing Tax Law (until 12/17/17)

The current tax law has been in place since 1917. Its main purposes are to: 1) incentivize giving and 2) define the tax base so that taxable income is considered income *minus* charitable giving. Specifically, it provides an incentive to give for the twenty-five percent of taxpayers who itemize. In so doing, the current law limits the number of taxpayers having to file for small deductions (Saunders 2018). The standard deductions include:

- $6,300 for single taxpayer & $12,600 for joint return

Example: if someone makes $50,000 in income, and donates $10,000 in charitable giving, they are treated the same in their ability to pay taxes as someone with an income of $40,000 making no charitable donations.

Itemizing 101

Itemizing involves listing deductions for mortgage interest, state & local taxes, charitable donations, and others on Schedule A of a yearly tax return. Meaning, taxpayers who have deductions that exceed the standard deduction ($6,300 for single taxpayer and $12,600 for joint return) itemize to reduce their taxable income (Saunders 2018).

To put these statistics in another perspective, a higher percentage of Americans give to charity than vote! Specifically, in 2016, 75% of the $390 billion donated to philanthropies was generated from gifts from individuals (Frankel 2017).

Estimated Charitable Giving of Itemizers and Non-itemizers, 2017		
Previous Law Baseline	Itemizers	Non-Itemizers
Number of tax units	45,460	129,220
Percentage of total tax units	26	74
Total giving ($ billions)	239	53
Percentage of total giving	82	18

Figure 1. Estimated Charitable Giving of Itemizers and Non-itemizers, 2017 (under previous law). Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0516-01) (Tax Policy Center's Briefing Book).

Tax Cuts and Jobs Act (TCJA), H.R. 1

When the TCJA was signed into law December 17, 2017, the sweeping tax overhaul included:

- Doubling the standard deduction to $12,000 for single taxpayers and $24,000 for joint return/married couples

The implication is that many taxpayers who itemized in the past, will find it's no longer beneficial for them to do so (Saunders 2018).

Example: Mary and her husband, Jim, donate $8,000 to charities each year, their mortgage is paid off and their only itemized deduction is $10,000 in state and local taxes, totaling $18,000.

- For Tax Year 2017, they will itemize because $18,000 is larger than the standard $12,600
- For Tax Year 2018, they will likely take the standard deduction of $24,000 because it exceeds the $18,000 on Schedule A.

(Associated Press, CBS, Dec. 28, 2017)

(To review the full details of the many legislative changes of the TCJA and the impact on charitable nonprofits, please see the regularly updated report "Tax Cuts and Jobs Act, H.R. 1 Nonprofit Analysis of the Final Tax Law" provided by the National Council of Nonprofits, https://www.councilofnonprofits.org/sites/default/files/documents/tax-bill-summary-chart.pdf.)

General Impacts

In reviewing the pre-TCJA and current law columns on "Tax Units with a Benefit from Charitable Deduction" in Figure 2, the number of taxpaying units who receive this benefit is reduced by more than half across the third, fourth, and top income quintiles. In reducing the number of taxpayers who are able to itemize, one conclusion to be drawn is the corresponding reduced incentive to give for those in that group.

As a result of the change, the charitable deduction would be out of reach of more than 87 percent of taxpayers (was 74 percent). The Joint Committee on Taxation (JCT) estimates that itemized deductions will drop by $95 billion in 2018. Not all of this would disappear; the change is estimated to *shrink giving to the work of charitable nonprofits by $13 billion or more each year*. Estimates are that this drop in giving would cost 220,000 to 264,000 nonprofit jobs. The percent of itemizers drops by half from 26 percent to 13 percent ("Tax Cuts and Jobs Act, H.R. 1 Nonprofit Analysis of the Final Tax Law" Feb. 22, 2018). The share of middle-income households, (up to $86,100) claiming the charitable deduction falls by two-thirds, from 17 percent to 5.5 percent and those households making between $86,000 and $149,400 falls from 39 percent to 15 percent (Gleckman 2018).

Reducing estate tax could also negatively affect charitable giving because it reduces higher income individuals' incentive to give ("Tax Policy Center's Briefing Book" Key Elements of the U.S. Tax System). Now individuals can leave double the previous amount ($11 million for individuals or $22 million for couples) to their heirs to avoid estate taxes—so this could be money they may have otherwise given to charitable donations.

The after-tax cost of giving is the value of gifts minus tax benefits received. For instance, if an itemizing taxpayer has a marginal tax rate of 29 percent—or the tax rate on the last dollars of income, and they give $100 to an orchestra, the donation reduces the income tax bill for that person by $29, so the deductible gift has a cost of only $71. $29 is considered what the federal government subsidizes for giving. There is an inverse relationship between tax rates and the after-tax "price" of charitable giving. Meaning as tax rates increase, the after-tax price decreases ("Tax Policy Center's Briefing Book" Key Elements of the U.S. Tax System).

As the landscape shifts towards fewer taxpayers taking itemized deductions, the TCJA's individual tax changes also reduces the average marginal tax benefit of donations from 20.7 percent to 15.2 percent (Gleckman 2018). While the benefit of giving declines significantly for low- and moderate-income itemizers, there is little change for the highest-income taxpayers. Specifically, the marginal tax rate for middle-income taxpayers falls from 8.1 percent to 3.3 percent. For the top one percent income earners, it will fall only from 30.5 percent to 28.9 percent (Gleckman 2018).

A result of these tax changes means that wealthier donors will be even more important to charitable organizations in the future because more donations will likely come from fewer, wealthier donors (Gleckman 2018).

Strategies

In C. Eugene Steuerle's article "How Both Public Tax Reform and Private Sector Initiatives Can Strengthen Char-

Impact on the Tax Benefit of the Itemized Deduction for Charitable Contributions of TCJA

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Table T18-0010
Impact on the Tax Benefit of the Itemized Deduction for Charitable Contributions of H.R.1, The Tax Cuts and Jobs Act (TCJA)
By Expanded Cash Income Percentile, 2018 [1]

Expanded Cash Income Percentiles[2,3]	Tax Units		Pre-TCJA Law						Current Law					
			Tax Units with a Benefit from Charitable Deduction		Tax Benefit of Charitable Deduction				Tax Units with a Benefit from Charitable Deduction		Tax Benefit of Charitable Deduction			
					For Tax Units with a Benefit		For All Tax Units				For Tax Units with a Benefit		For All Tax Units	
	Number (thousands)	Percent of total	Number (thousands)	Percent within Class	Average ($)	As Percent of After-Tax Income	Average ($)	As Percent of After-Tax Income	Number (thousands)	Percent within Class	Average ($)	As Percent of After-Tax Income	Average ($)	As Percent of After-Tax Income
Lowest Quintile	48,780	27.7	190	0.4	170	0.9	*	**	40	0.1	100	0.5	*	**
Second Quintile	38,760	22.0	1,630	4.2	280	0.8	10	*	470	1.2	240	0.7	*	**
Third Quintile	34,280	19.5	5,910	17.2	420	0.7	70	0.1	1,890	5.5	390	0.6	20	*
Fourth Quintile	28,870	16.4	11,290	39.1	680	0.7	260	0.3	4,310	14.9	660	0.7	100	0.1
Top Quintile	24,300	13.8	18,050	74.3	2,920	1.0	2,170	0.8	9,290	38.2	4,120	1.2	1,570	0.6
All	176,100	100.0	37,060	21.0	1,710	1.0	360	0.5	15,990	9.1	2,620	1.1	240	0.3
Addendum														
80-90	12,490	7.1	8,340	66.8	1,040	0.7	700	0.5	3,370	27.0	1,050	0.7	280	0.2
90-95	6,020	3.4	4,690	77.9	1,530	0.8	1,190	0.6	2,400	39.9	1,480	0.7	590	0.3
95-99	4,650	2.6	4,020	86.5	2,970	0.9	2,570	0.8	2,650	57.0	2,860	0.8	1,630	0.5
Top 1 Percent	1,140	0.7	1,000	87.7	24,890	1.6	21,800	1.4	870	76.3	27,200	1.7	20,660	1.3
Top 0.1 Percent	120	0.1	100	83.3	142,080	2.0	128,240	1.8	90	75.0	158,370	2.2	126,510	1.7

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0217-1).
* Non-zero value rounded to zero; ** Insufficient data
(1) Calendar year. Current law includes the provisions in H.R.1, The Tax Cuts and Jobs Act, signed by the President on December 22, 2017. Excludes effects of repealing the ACA's Individual Shared Responsibility Payment (i.e., individual mandate).
(2) Includes both filing and non-filing units but excludes those that are dependents of other tax units. Tax units with negative adjusted gross income are excluded from their respective income class but are included in the totals. For a description of expanded cash income, see
http://www.taxpolicycenter.org/TaxModel/income.cfm
(3) The income percentile classes used in this table are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks are (in 2017 dollars): 20% $25,000; 40% $48,600; 60% $86,100; 80% $149,400; 90% $216,800; 95% $307,900; 99% $732,800; 99.9% $3,439,900.

A closer look…

Expanded Cash Income Percentiles[2,3]	Pre-TCJA Law: Tax Units with a Benefit from Charitable Deduction		Current Law: Tax Units with a Benefit from Charitable Deduction	
	Number (thousands)	Percent within Class	Number (thousands)	Percent within Class
Lowest Quintile (up to $25,000)	190	0.4	40	0.1
Second Quintile (up to $48,600)	1,630	4.2	470	1.2
Third Quintile (up to $86,100)	5,910	17.2	1,890	5.5
Fourth Quintile (up to $149,400)	11,290	39.1	4,310	14.9
Top Quintile (above $149,401)	18,050	74.3	9,290	38.2
All	37,060	21.0	15,990	9.1
Addendum				
80-90 ($149,401 - $216,800)	8,340	66.8	3,370	27.0
90-95 ($216,801 – $307,900)	4,690	77.9	2,400	39.9
95-99 ($307,901 - $732,800)	4,020	86.5	2,650	57.0
Top 1 Percent ($732,801- $3,439,899)	1,000	87.7	870	76.3
Top 0.1 Percent ($3,439,900 and up)	100	83.3	90	75.0

Figure 2. Impact on the Tax Benefit of the Itemized Deduction for Charitable Contributions of TCJA. Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0217-1) highlighting relevant columns.

ities," the author summarizes several ways both through governmental tax reform and charities themselves can strategize for future donations.

Regarding tax reform, Steuerle makes a push for allowing all taxpayers, including non-itemizers, to be allowed a tax deduction for contributions at or above a minimal amount. Further analysis of the rationale for this reform may be discovered through "The New Debate over a Charitable Deduction for Non-itemizers" by Joseph Rosenberg, et al., Urban Institute October 2016. Steuerle also recommends extending the deduction to gifts made by April 15 or the filing of one's return. This would parallel the same practice currently in place for the extended contribution date for Individual Retirement Account contributions. Along those lines, he also recommends making it easier for individuals to donate from their IRA accounts.

Some actions charitable organizations could take on their own are continuing to tell powerful stories about their missions and the generous people who support them. Providing information on the organization in an easily accessible, compelling way is a necessity for generous giving. Some organizations have had success in encouraging people to give to charity when settling disputes. And continually educating and encouraging wealth advisers to remind their clients of the benefits of charitable giving should continue (Steuerle 2017). One outcome of the TCJA could be both a strategy/opportunity and a threat. Some donors may refrain from making their usual yearly donation and bundle several years together in a single, larger gift to benefit from the tax advantages (Frankel 2017). Budgeting for these types of gifts could present entirely new cash flow issues for already financially strapped organizations.

It is important to remember that for many high-net-worth families, the tax benefits of giving take a back seat to their desire to express their passions and to make a lasting impact for the future (Joyce 2018). For all donors, personal connection is the key motivation to giving, with the face-to-face ask yielding the highest results (American Red Cross Holiday Poll 2014).

Advocacy and Lobbying

A brief discussion on advocacy and lobbying is necessary as they both can impact charitable donations, yet can sometimes be confused. Advocacy is building trust between you and your elected officials and promoting your cause. General arguments about the importance of music education or explaining the benefit of an artist donating their work to museums are considered advocacy (Birch 2006).

Lobbying on the other hand, is taking action to try and influence the voting of legislators. Asking a politician to vote "yes" on an increase for arts education in an appropriations bill or to support a bill that provides an artist with the full value of their artistic donation for charitable deduction, are both lobbying (Birch 2006). Both arts organizations and their board members need to be more informed about the importance of both advocacy and lobbying when it comes to their artistic missions. 'It's illegal for nonprofits to lobby' or 'Lobbying is for paid experts with insider information,' are both common myths (Birch 2006).

Inviting legislators to arts events, and bragging to them about what your organization is doing or has achieved is useful information to them. Above all, advocacy succeeds with stories—about arts in schools, rural arts programs, making arts available to more people, changing lives of young people, revitalization of dying communities, arts and job creation, programs that exhibit grassroots constituency get attention (Birch 2006)!

There is broad flexibility for 501c3 organizations, namely they are allowed to spend no more than five percent of total expenditures (less than a "substantial amount") on lobbying. However, lobbying by nonprofit groups is not an expensive endeavor (some staff time, volunteer time) and it's very unlikely for charity organizations to even come close to this threshold. Through concerted effort of organizations to create advocacy committees and provide board training on advocacy, it is possible to instill both beliefs that 1) lobbying is not difficult (the heart of lobbying is a persuasive story) and 2) advocacy is a pillar for our democratic form of government (Birch 2006).

Looking to the Future/Conclusion

Arts organizations/charities should be on alert for damage from policies not aimed directly at them. And Congress won't decide sweeping tax laws *solely/primarily* on the effects on the charitable sector (Steuerle 2018).

> Charities must think longer-term as the nation struggles to define a modern set of public policies and societal goals relevant to 21st century needs. My suggestions are intended to extend well beyond any current political battle. Fighting to maintain the status quo is not a strategic option. Nor should every charity expect to come out unscathed in this rapidly changing environment. But the U.S. is facing important choices as it decides the direction and size of government in the Trump era. That debate ought to include a broad look at charities in this new environment and whether that includes strengthening, though reforming, the role of charities in American life. (C. Eugene Steuerle, Tax Policy Center, Urban Institute & Brookings Institution April 24, 2017)

In conclusion, this paper attempts to illustrate one aspect of the recent Tax Cuts and Jobs Act (TCJA)—namely the potential impact on future charitable giving for arts organizations, but it is not a comprehensive examination of tax reform. Readers are encouraged to explore TCJA more thoroughly to gather a full grasp of the act. As this topic does specifically relate to arts organization management, educators would want to be aware of this recent tax change and potential impact on fundraising when preparing nonprofit arts sector curriculum, as well as when they are contributors, advisors, and board members themselves for arts organizations.

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Proceedings

of the

2018 International Summit

of the

Music & Entertainment Industry Educators Association

– Los Angeles –

2018

March 22 – 24, 2018 • Embassy Suites by Hilton • Los Angeles/Glendale