

# ISSUE BRIEF **07.20.20**

## Nonprofit Assistance during the Covid-19 Pandemic

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The Covid-19 pandemic has posed serious challenges to nonprofit entities. Museums and performing arts centers have been required to halt their routine operations and are experiencing plummeting patronage. Universities and professional organizations have had to reimagine their program delivery through online channels to engage their constituents. Food banks are facing unprecedented demand and have been operating at full throttle. Despite different challenges from an operational perspective, all types of nonprofits are experiencing financial stress from increased costs, reduced revenue, or both. This issue brief explores the federal government's key nonprofit aid policies during the Covid-19 pandemic and discusses different approaches to help these entities financially.

### EXISTING POLICY INSTRUMENTS THROUGH LOANS, GRANTS, AND TAXES

The federal government's pandemic relief packages include several provisions that are applicable to nonprofit entities. This assistance is generally delivered through loans, grants, and tax-based instruments.

#### Loans

There are several loan-based programs from the Coronavirus Aid, Relief and Economic Security Act (also known as the CARES Act) that benefit nonprofit entities, although these programs are not written exclusively for nonprofits.<sup>1</sup> Besides the Paycheck Protection Program (PPP), the CARES Act

establishes a mid-sized business loan program where entities with between 500 and 15,000 employees can apply for loans at favorable rates. However, this program is not yet operational, and limited details have been released to date.<sup>2</sup>

#### Grants

The CARES Act authorizes funds to numerous nonprofit-specific assistance programs. However, only a fraction of the funds have been distributed to the intended beneficiaries.<sup>3</sup> For instance, the Families First Coronavirus Response Act (also known as the FFCRA),<sup>4</sup> the second Covid-19 relief package, authorized \$400 million to the Commodity Assistance Program to provide funds for emergency food assistance. The CARES Act authorized another \$450 million under the Commodity Assistance Program, for a total of \$850 million allocated by Congress to provide emergency food purchasing and distribution. Preliminary numbers show that approximately \$300 million has already been distributed.

The CARES Act also provides funds for certain nonprofit functions. For instance, \$75 million in grant money was allocated to the National Endowment of the Arts, which includes funding for state arts agencies and regional arts organizations. A separate \$75 million was allocated to the National Endowment for the Humanities, including funds to state humanities councils. Another example is the \$1 billion of community service block grants that will be distributed by states and benefit local community-based organizations. A \$3.5 billion childcare



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and development block grant, which allows states to offer assistance to childcare service providers experiencing decreased enrollment or closures due to the coronavirus pandemic, may benefit some nonprofits. The CARES Act also allocates funds for organizations that help homeless youth, protect and advocate for victims of domestic violence, and assist people with substance abuse and mental health-related issues.

In addition, the CARES Act allocates funds to nonprofits in specific sectors including health care and higher education institutions. For instance, \$100 billion was allocated for the Public Health and Social Services Emergency Fund to help health care providers with pandemic-related expenses or lost revenue attributable to the pandemic. The providers include public, for-profit, and nonprofit entities. The Paycheck Protection Program and Health Care Enhancement Act<sup>5</sup> provides an additional \$75 billion to the Public Health and Social Services Emergency Fund. For higher education institutions, the CARES Act provides approximately \$14 billion through the Higher Education Emergency Relief funds, as long as the majority of the money is spent on emergency financial aid for students.

#### **Payroll Tax Credit and Deferral**

The CARES Act also includes relief delivered through the tax code. Some benefits are applicable to all taxpayers, while others are specific to nonprofits.

The CARES Act authorizes an employee retention tax credit (ERTC) and an employer payroll tax deferral (EPTD) for both businesses and nonprofits. The ERTC is applicable to nonprofits whose operations were fully or partially suspended as a result of government shutdown orders, or nonprofits whose gross receipts decreased by at least 50% in a certain quarter of 2020 when compared to the same quarter of 2019. Qualified entities may receive a refundable tax credit against payroll taxes paid, equal to 50% of employee wages at up to \$10,000 between March 13 and December 31, 2020. Employers are not eligible for the ERTC if they receive PPP loans, because both programs have a similar purpose of retaining employees on payroll.

The EPTD specifies that employers of

any size, including the self-employed and nonprofit entities, can defer the employer portion of the Social Security tax (6.2% of up to \$137,700 of wages per employee in 2020) that is scheduled to be paid from March 27 to December 31, 2020. However, Medicare taxes and the employee portion of the Social Security tax are not deferred, and the payment schedules are still the same as prior to the pandemic. Half of the deferred amount must be paid by December 31, 2021, and the remaining half is due before December 31, 2022. The EPTD previously precluded PPP participants who have loans forgiven from getting the tax benefit; however, the Paycheck Protection Program Flexibility Act<sup>6</sup> removed the restrictions and allowed PPP loan recipients to also defer payroll tax payments.

#### **Unrelated Business Income**

Although the nonprofits do not pay federal income taxes themselves, they may have unrelated business income (UBI) that is subject to tax.<sup>7</sup> UBI is income from a trade or business that is not substantially related to the charitable purpose that forms the basis of the organization's exemption.

The Tax Cuts and Jobs Act of 2017 (TCJA)<sup>8</sup> changed the net operating loss (NOL) deductions rules, repealing NOL carrybacks while allowing indefinite carryforwards. The CARES Act temporarily allows any NOLs arising in 2018, 2019, and 2020 to be carried back for five years preceding the taxable year of such a loss. As such, nonprofits that have previously paid taxes on their UBI can claim refunds under this provision. The TCJA also installed a ceiling at 80% of taxable income that can be used to offset losses; the CARES Act repeals this limitation and allows the NOLs to offset 100% of taxable income.<sup>9</sup> Although these provisions allow taxpayers to utilize losses and receive liquidity quickly, some believe they are overly generous, especially when used by for-profit businesses. This is because the NOLs can be carried back to taxable years prior to the enactment of the TCJA when the corporate income tax rate was 35%.<sup>10</sup>

### Universal Charitable Contribution Deduction

Taxpayers' charitable giving amounts are typically associated with several economic factors including financial market returns, gross domestic product growth rate, consumer spending, and employment rate. All these indicators now point to reduced charitable donations. In light of this, lawmakers responded by including two provisions regarding charitable contribution deduction for nonprofit entities in the CARES Act.

First, the TCJA increased the annual charitable contribution deduction limit for donors who claim itemized deductions from 50% to 60% of the adjusted gross income (AGI). The CARES Act temporarily removes the AGI limitation on donors' cash contributions to certain charitable organizations, meaning that donors essentially can claim charitable contribution deductions at up to 100% of their AGI. Charitable contributions that exceed the AGI may be carried forward for up to five years.<sup>11</sup>

This provision may benefit charitable organizations this year by accelerating the timeline for donors' contributions. Some practitioners see this as a win-win for both the nonprofit organizations and the donors: affluent donors who are less affected by the pandemic can use this provision to reduce their tax liability, whereas nonprofits benefit from cash donations when they need liquidity the most. However, others take a more skeptical view as they doubt the policy will increase the total amount of giving by these individuals.<sup>12</sup> Instead, the policy simply enables donors to shift future giving to the current year without stimulating more charitable contributions; the total amount of giving remains the same.

Under current design, the charitable contribution deduction only benefits taxpayers who claim itemized deductions on their income tax returns. As such, the tax benefits increase with marginal tax rates, allowing higher-income taxpayers to receive more benefits. After the TCJA, as a result of the increased standard deduction amount, only approximately 10% of taxpayers claimed itemized deductions on their tax returns, and these taxpayers were more likely to

have sizable mortgages or higher incomes.

To create incentives for taxpayers who claim standard deductions, the CARES Act separately allows a \$300 deduction for these filers in 2020. This deduction is applied on a per return basis, meaning that a married couple who filed jointly will only be able to claim a \$300 instead of a \$600 deduction.<sup>13</sup>

Supporters have applauded Congress for adding the universal charitable contribution deduction, but they want Congress to either remove the deduction limit or substantially increase the \$300 amount for standard deduction taxpayers. Several lawmakers introduced bills to propose such changes: H.R. 6408 proposed to extend the charitable contribution deduction to all taxpayers,<sup>14</sup> and H.R. 6490 proposed to increase the deduction from \$300 to one-third of the standard deduction (in 2020, the standard deduction amounts are \$12,400 for individuals and \$24,800 for married taxpayers filed jointly).<sup>15</sup>

The idea of allowing universal charitable contribution deductions is not new, but critics argue there are three major issues with this approach. First, the deductions are hard to police and, as a result, have a high tendency of being abused.<sup>16</sup> The small amount currently authorized (\$300) also means it is not practical for the IRS to audit at the taxpayer level.

Under the current design, there is not an effective information reporting mechanism that allows the IRS to check the legitimacy and amount of the donations. Although one could argue that with the assistance of technology and the increased popularity of online giving, the federal government could establish a new reporting mechanism that requires nonprofits to report the details of such contributions to the IRS, it still constitutes an additional compliance burden to the smaller nonprofits.

The second issue is that the universal charitable deduction may not be the most effective way to stimulate additional giving. When the government provides a more generous charitable tax deduction, taxpayers tend to give more. In theory, if taxpayers are sensitive to tax incentives, the lost tax revenue roughly offsets the increase in contributions received by nonprofits.

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Because taxpayers essentially increase their donations by about the same amount as the reduction in their tax bills, funds simply shift from the government to charity. Thus, there is a stronger case for using tax instruments to incentivize charitable contributions, as taxpayers' charitable giving decisions are responsive to tax benefits.

On the other hand, if taxpayers' giving is not so responsive to changes in tax benefits, when the government makes the charitable tax deduction more generous, taxpayers are still going to give more. However, a decrease in tax revenue from increased subsidies would be more than the increase in private giving. In this case, one could argue that the government should scale back the tax incentives and use revenue from taxes to provide direct grants to charities instead of using tax deductions to incentivize taxpayers.

Economic literature has extensively investigated taxpayers' responsiveness to tax incentives but has generated no conclusive results.<sup>17</sup> Studies conducted within the last two decades show that households are no longer as responsive to the tax deductibility of charitable contributions as in earlier decades. The only group that is consistently responsive to tax incentives is high-income donors. Therefore, forgoing tax revenue to provide deductions for charitable contributions may not stimulate as much giving to charities as one expects, except for high-income taxpayers.

Finally, the universal charitable contribution deduction is a costly policy. The Joint Committee on Taxation estimated the \$300 deduction will cost \$1.5 billion in terms of lost tax revenue.<sup>18</sup> In addition, under the pre-TCJA system, researchers who use 2016 as a base year found that migrating to the universal deduction would cost \$13.1 billion in that year.<sup>19</sup> Given the current fiscal outlook of the federal government after the relief packages so far, any revenue reduction policies need to be carefully designed and targeted.

## WHO IS THE FAIREST OF THEM ALL?

Nonprofit entities play an important role at both the national and community levels, and they are experiencing financial difficulties caused by the pandemic. There are several policy tools to address nonprofits' financial needs, but with limited resources, it would be wise to first decide what these funds are aiming to accomplish. Should the assistance be designed to keep employees on payroll or to ramp up operations after the shelter-in-place orders? Should short-term liquidity that helps nonprofits respond to surges in demand be a priority, or should longer-term assistance that facilitates sustainable service delivery be considered more valuable?

Grants can provide the most direct and immediate assistance to cash-constrained nonprofits, and a fair portion of the authorized funds to date are block grants with limited strings attached. The most pressing issue is to expedite the distribution of program funds already authorized under the FFCRA and the CARES Act. Many government entities are tasked with issuing new regulations and distributing enormous amounts of aid in a short time. Balancing the urgency of delivering funds to recipients and adhering to regulations is not easy. When the discussion of the next relief package is underway, it would be diligent to first implement or modify existing programs to see how the effects play out before creating new programs that generate more backlog.

Similar issues apply to loans. The \$454 billion mid-sized business loan program that could help nonprofit entities maintain their payroll is not yet operational. Although there have been discussions about allowing more flexible use of funds and providing a loan forgiveness option to nonprofit borrowers, a starting point would be speeding up the implementation of this program.

Finally, for tax-related instruments, the jury is still out for whether a large-scale universal charitable contribution deduction is an effective way to stimulate individual contributions. If the policy objective is to encourage individual donations during the pandemic, given the potential high cost of the policy, removing the charitable

contribution deduction dollar limit or replacing the current amount with a high limit should be a temporary policy to ensure the disciplined use of tax revenue.

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