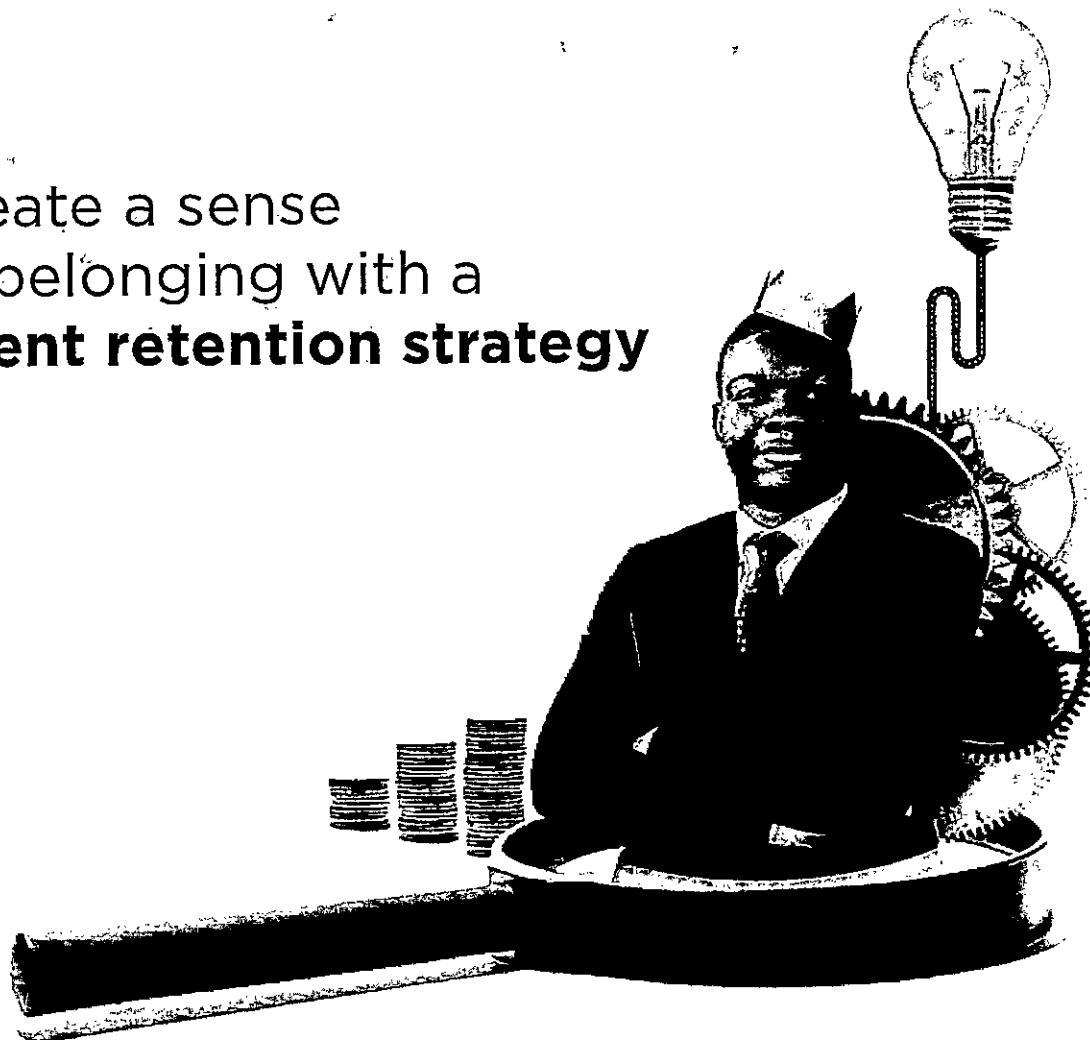


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What you should
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What you should know about SGOs

By Randall W. Luecke, CPA, CMA, CAP, and Dennis A. Linden, CPA

Never heard of an SGO? You're forgiven; they're brand new in Ohio. Scholarship Granting Organizations (SGOs) have been around in other states for many years, but they're finally coming to Ohio, beginning September 30, as part of the biennial budget approved last year by Ohio's Legislature.

What is an SGO?

Scholarship Granting Organizations are remarkably simple. They are religious or nonreligious 501(c)(3) nonprofit organizations that do two things: (1) raise scholarship funds from donors, and (2) disburse scholarship funds to students, primarily from kindergarten to grade 12. Students from low-income households who attend public schools receive priority when scholarships are awarded.

How do they work?

Contributions up to \$750 to an SGO are eligible for a dollar for dollar nonrefundable tax credit on the donor's State of Ohio tax return. A tax credit to a charitable contribution is superior from a tax-paying standpoint because it reduces the income tax liability of the tax donor.

Do the SGOs in other states work the same way?

No. Numerous states have SGOs, but they work a little differently in each state. In Indiana, for example, where SGOs have existed for more than nine years, the tax credit for a donation is only 50 cents on the dollar, but for an unlimited amount. That means a taxpayer in Indiana could make a \$5,000 contribution to an SGO and receive a \$2,500 tax credit.

What is the process for establishing an SGO?

To establish an SGO, an existing 501(c)(3) organization needs to complete an application and file it with The Ohio's Attorney General's Office. In the event that a new organization is being

formed to become an SGO, it would first need to incorporate with Ohio's Secretary of State's Office by:

- Applying for a federal tax identification number with the IRS
- Filing Form 1023
- Applying for Recognition of Exemption with IRS to be deemed a 501(c)(3) organization
- Filing the application with Ohio's Attorney General's Office to be approved as an SGO.

The application must be accompanied by the following documents:

1. A copy of the organization's bylaws;
2. A copy of the organization's formation documents;
3. Documentation that it gives priority to low-income students when processing awards for scholarship;
4. Documentation showing that it primarily gives academic scholarships to primary and secondary students when processing awards for academic scholarships; and
5. A notarized statement indicating how the scholarship granting organization meets the requirements to be certified by the attorney general under this section.¹

How many SGOs will there be in Ohio?

It is impossible to predict how many SGOs there will be in Ohio. It will depend on how many nonprofit organizations apply and how many are approved. In Indiana there are only seven SGOs.

Why should my client use an SGO?

If your client – an individual or business – wishes to support academic scholarship, especially among low-income students, a contribution to an SGO results in a nonrefundable tax credit on their Ohio income tax return, as opposed to a charitable contribution deduction on their federal return. Tax credits reduce the taxpayer's income tax liability dollar for dollar, whereas the charitable deduction is worth only cents on the dollar, only in the event that the taxpayer itemizes on their federal return.

Will SGOs in Ohio issue receipts or letters acknowledging donations?

It is imperative that SGOs issue a receipt or a letter acknowledging the donation and specifying that the donation is eligible for a State of Ohio tax credit under section 5747.73 of the Ohio Revised Code. In the absence of this information, the tax preparer might think that the donation is a charitable

donation on the client's federal tax return instead of a nonrefundable tax credit on client's State of Ohio return. Here are the tax implications of such an error:

	Scenario I	Scenario II	Scenario III
Tax savings attributable to charitable donation on taxpayer's federal return	\$ - 0 -	\$90	\$ - 0 -
Savings on State of Ohio return due to tax credit	\$ - 0 -	\$ - 0 -	\$750
Total tax savings on federal and state returns attributable to \$750 donation to the SGO	\$ - 0 -	\$90	\$750

In Scenario I: the tax preparer didn't realize that the donation to the SGO was eligible for an Ohio nonrefundable tax credit, and assumed it was a charitable donation. But since the client did not have sufficient deductions to itemize, the tax preparer used the standard deduction for the client, and the charitable donation had no impact on the federal return.

In Scenario II: the client had sufficient deductions to itemize, so the charitable deduction on the federal return generated a \$90 tax savings (the client was in the 12% tax bracket).

In Scenario III: because an acknowledgment letter indicating that a donation was made to the SGO was issued, the tax preparer did not take a federal charitable deduction and instead claimed a dollar for dollar tax credit on the client's Ohio tax return that yielded a tax savings of \$750.

How do I manage my client's contribution to an SGO?

First, if your client made the donation by check, make sure that it was made payable directly to an SGO – not a participating school. Second, ensure your client's check was deposited (or online donation was made) before Dec. 31 to take the tax credit on the current year's tax return. Third, make sure that the donation was to an SGO approved by the Attorney General's office (you can check the approved SGOs on the Attorney General Office's website). If the donation meets these criteria, the donation may be taken dollar for dollar up to \$750 as a nonrefundable tax credit against your client's state tax liability. If the donation exceeds \$750, the excess can be taken as a charitable deduction on your client's federal tax return.

What impact will an SGO donation have on my client's state tax liability?

	Scenario I	Scenario II	Scenario III
Taxpayer liability before applying tax credits	\$2,425	\$645	\$ - 0 -
Nonrefundable tax credit for SGO donation	\$750	\$750	\$750
Taxpayer owes the State of Ohio	\$1,675	\$ - 0 -	\$ - 0 -

In Scenario I: the tax credit for the donation to the SGO decreases the tax liability and the credit is fully utilized.

In Scenario II: the taxpayer applies the nonrefundable tax credit (after using other tax credits such as the joint filing credit or the retirement income credit) to completely eliminate the tax liability of the taxpayer. Because the taxpayer has only used \$645 of the nonrefundable tax credit to eliminate their tax liability, the remaining amount can be taken as a charitable deduction on their federal tax return.

In Scenario III: the taxpayer was already going to receive a refund. As a consequence, the donation to the SGO yields no benefit from an Ohio income tax perspective, but the entire \$750 donation can still be claimed as a charitable deduction on the client federal return.

These scenarios illustrate that the individuals for whom the SGO donation does the most good, from a tax payment standpoint, are those individuals with a State of Ohio tax liability in excess of \$750.

Do SGOs only accept cash?

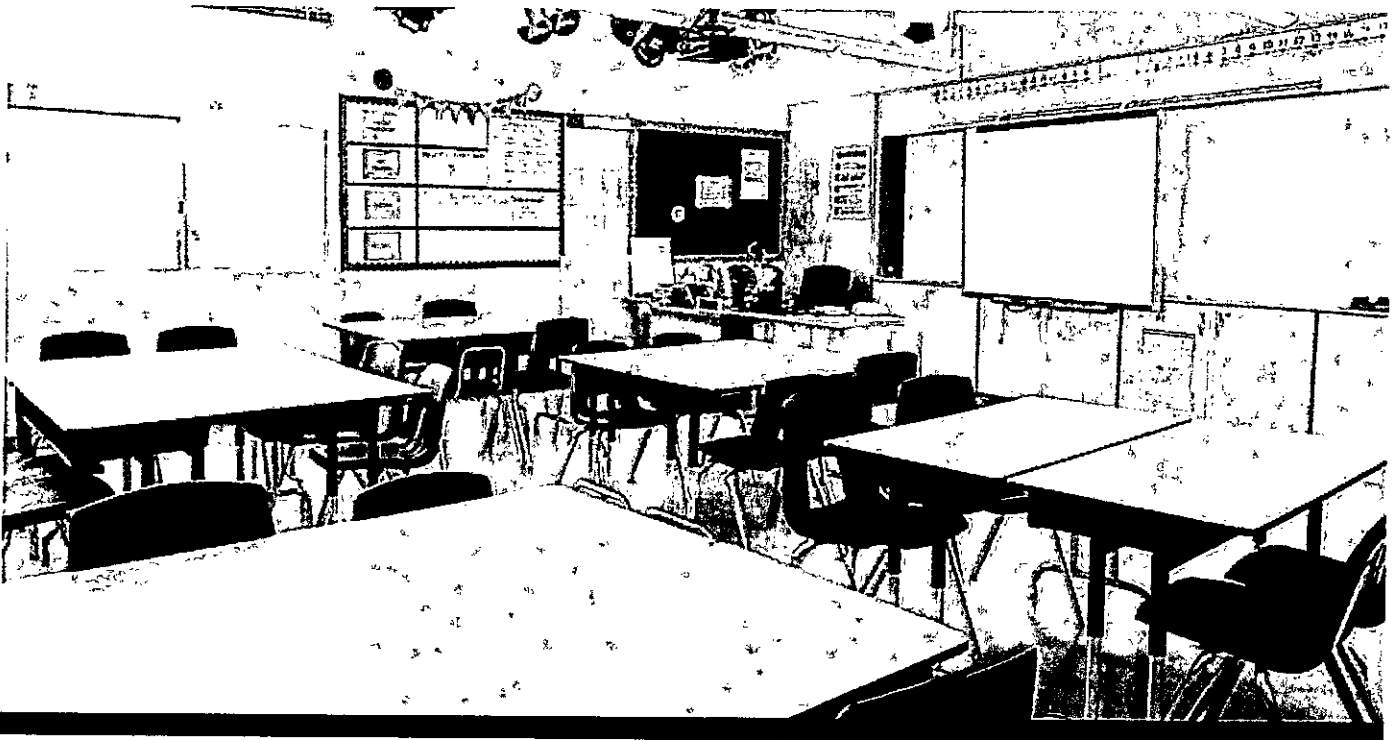
That depends on the Gift Acceptance Policy of the SGOs that are formed in Ohio. In other states, the SGOs accept a wide variety of non-cash donations including appreciated stock, precious metals, land, grain, and cattle. Only cash donations will result in the Ohio nonrefundable tax credit up to \$750; the other forms of donations will result in a federal charitable contribution deduction.

How do SGOs distribute scholarship funds?

SGOs can either award and distribute scholarship funds directly to students, or distribute scholarship funds to participating schools with which the SGO has an agreement. In either event, the SGO or the participating school must have a scholarship application process, must approve scholarships after verifying the household income of the student, and must prioritize scholarships for students of low-income households (currently defined as 300% of the federal poverty level). Records must be maintained for all donations received and all scholarship amounts awarded.

Conclusion

If the Ohio experience with SGOs matches that of other states that have established them, SGOs will serve to raise significant scholarship dollars that will primarily be awarded



to students, kindergarten through grade 12, prioritizing students from low-income households. This may position a significant number of students to now be able to afford a nonpublic school of their choosing. Individuals and businesses who value nonpublic education alternatives should take advantage of lowering their state income tax liability by donating the maximum amount (\$750) to an Attorney General Office-approved Scholarship Granting Organization.

Here is a sample acknowledgement letter for use by an SGO to position the tax preparer to manage the federal and state tax implications of a donation:

Dear Donor:

Thank you for your \$XXX.XX donation to the (Ohio SGO). Your donation will be used to grant scholarships, primarily to students in kindergarten to 12th grade, in participating elementary, middle and secondary schools throughout the State of Ohio. Scholarship awards will be prioritized for students of low-income households, currently defined as households under 300% of the federal poverty threshold.

Your donation may be taken as a dollar-for-dollar nonrefundable tax credit, up to \$750, under Section 5747.73 of the Ohio Revised Code.

Should you or your tax preparer have any questions with regards to the eligibility of your tax credit, or how it should be applied on your next state income tax return, please do not hesitate to contact the undersigned.

Thank you, again, for your donation, and for your support in meeting the educational needs of Ohio students from low-income households.

Sincerely,

John Smith
Executive Director



Randall W. Luecke, CPA, CMA, CAP, is executive director of the Lutheran Scholarship Granting Organization of Ohio. He has 13 years of public accounting experience, and more than 30 years of C-suite experience with a variety of

nonprofit organizations. He is a former editor of the Ohio CPA Journal and has authored more than 70 articles in numerous accounting trade journals including the Journal of Accountancy. He can be reached at rluecke@clhsa.org.



Dennis A. Linden, CPA, is a director for CBIZ MHM in its Northeast Ohio Accounting, Tax & Advisory practice. He has more than 40 years of public accounting experience with a focus on tax planning and compliance for closely held

businesses, individuals, trusts and estates. He currently serves on the local board of directors of the Society of Financial Service Professionals.

THREE THINGS

1. SGOs, which became possible in Ohio Sept. 30, are nonprofit organizations that raise scholarship funds from donors, and disburse those funds to students, primarily K-12, prioritizing students from low-income households, who attend participating nonpublic schools.
2. Individuals and businesses who value nonpublic education alternatives should take advantage of lowering their state income tax liability by donating the maximum amount (\$750) to an Attorney General Office-approved Scholarship Granting Organization.
3. It is important for accounting professionals to understand the state requirements regarding SGOs, as well as their potential benefits for taxpayers and nonprofits.

¹State of Ohio, Attorney General's Office, Charitable Law Section: "Amended Draft Rules – Scholarship Granting Organizations – 109:1-8-01.