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CPAs and Business Consultants

Preparing for the New 990

Maryland Association of
Nonprofits

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Objectives

- 990
 - What
 - Why
 - How

What

- 990 is changing starting with returns due in 2009 and after (without extension)
- So, 12/31 year ends will file first in 2009
- transition relief available for smaller organizations for 2008 and 2009 tax years, which allows many smaller organizations to file Form 990-EZ rather than the new Form 990 for such years, and summarizes the new reporting requirements for small organizations required to file Form 990-N.

- *Form 990-EZ Filing Requirements for 2008-2010. Form 990-EZ, Short Form Return of Organization Exempt From Income Tax, may be filed by most organizations with gross receipts and total assets below certain amounts. For the 2008 tax year, most organizations with gross receipts less than \$1,000,000 and total assets less than \$2,500,000 may choose to file the Form 990 or Form 990-EZ. (For the 2007 tax year, these amounts were less than \$100,000 gross receipts and \$250,000 total assets.) Similarly, most organizations with gross receipts less than \$500,000 and total assets less than \$1,250,000 may choose to file the Form 990 or Form 990-EZ for the 2009 tax year. Beginning with the 2010 tax year, most organizations with gross receipts less than \$200,000 and total assets less than \$500,000 may file either the Form 990 or Form 990-EZ.*
- Although Form 990-EZ was not redesigned for 2008, some changes have been made so that certain information previously required to be submitted as attachments will now be reported on schedules. Organizations that file Form 990-EZ (2008) must review the instructions for Schedules A, B, C, E, G, L, and N to determine whether they must report any of their activities or information on those schedules.
- *New annual electronic filing requirement for small tax-exempt organizations. Most small tax-exempt organizations (those normally with annual gross receipts up to \$25,000) now must file new Form 990-N, Electronic Notice (e-Postcard) for Tax-Exempt Organizations Not Required to File Form 990 or 990-EZ. See the IRS website at www.irs.gov and click on the Charities & Non-Profits tab for [more information](#).*

What are they after?

- **Excess Benefit Transactions**

- A section 501(c)(3) organization must not be organized or operated for the benefit of private interests, such as the creator or the creator's family, shareholders of the organization, other designated individuals, or persons controlled directly or indirectly by such private interests. No part of the net earnings of a section 501(c)(3) organization may inure to the benefit of any private shareholder or individual. A private shareholder or individual is a person having a personal and private interest in the activities of the organization

- Review compensation of key employees and independent contractors
- Credit counseling and others holding escrow funds
- Gaming activitie

Private Benefit (Inurement)

- Pursuant to Section 4958 of the Code, any 501(c)(3) organization which engages in an excess benefit transaction may be subject to **intermediate tax sanctions** by the IRS. An excess benefit transaction is a transaction in which any **economic benefit is provided by an applicable tax-exempt organization to a disqualified person** (board member, senior manager, or other **individuals who have substantial influence over the affairs of the organization**) if the value of the economic benefit provided exceeds the value of the consideration derived for providing the benefit. The sanctions are considered intermediate, because they are between the IRS not taking any action and a complete revocation of exemption. If a 501(c)(3) organization engages in an excess benefit transaction, the disqualified person who benefited must correct the transaction or repay the amount by which the benefit exceeded fair market value. Furthermore, the disqualified person and organization managers who knowingly participate in the transaction are subject to excise taxes. The proposed regulations issued by the IRS, set forth examples in which the IRS appears to take the position that organizational managers who are aware that an excess benefit has been conferred, but do not act to terminate and correct that transaction, are equally as culpable as managers who actively participated in approval of the transaction.

Examples of Private Inurement

- Unreasonable compensation.
- Unreasonable fringe benefits.
- Improper (personal) use of an organization's assets.
- Forgiveness of debts owed by insiders.
- Personal expenses being paid by the nonprofit.
- Low-interest or unsecured loans to insiders.
- Unreasonable housing allowances.
- Purchases, sales or property rental between the nonprofit and insiders that are not arms-length fair market value transactions

Actual or Potential Conflicts

- Organization policy requires competitive bidding on purchases of more than \$1,000, but a printing firm owned by a board member's spouse receives the \$25,000 contract for the annual report and no other bids are solicited.
- A board member serves on two boards in the community and finds himself in the position of approaching the same donors on behalf of both organizations.
- A staff member receives an honorarium for conducting a workshop for another group in the organization's field of interest.

Limits

- IRS does not prohibit a nonprofit from transacting business with employees or board members, however, policies and procedures should be in place to ensure these transactions will not be considered unreasonable benefit (excise benefit).
- Excise benefit is define as any transaction in which the nonprofit provides an economic benefit, directly or indirectly, to or for the use of any disqualified person. The economic benefit is a benefit that exceeds the value of what was received by the nonprofit in return for that benefit (typically the fair market value or the benefit).

Risks

- An excise tax will be imposed on the individual receiving the excise benefit equal to 25% of each excess benefit transaction.
- IRS may also revoke the nonprofit's tax-exempt status based on the following four factors:
 - Repeated excess benefit transactions.
 - The size and scope of the excess benefit transactions.
 - Whether the organization had implemented safeguards to prevent future recurrences of similar transactions.
 - Whether the transaction complied with applicable laws.

Have To's

- Written conflict of interest policy
 - Can do business or can't do business
 - Can use company truck or can't use company truck
 - Get 3 bids, etc.
 - Compensation determination – outsider vs. board?
- Establish procedures for the board and other disqualified persons to disclose any business dealings with the nonprofit

San Francisco Considering Cap on Executive Compensation at City Funded Nonprofits

- The San Francisco Chronicle (November 13, 2008) reported that **Supervisor Jake McGoldrick** is seeking to limit salaries and benefits for executives of San Francisco-funded nonprofits to six times the total compensation of their lowest-paid full-time employee. The proposed law would only apply to how the nonprofit uses city dollars. There are about 300 nonprofits that receive city funding.
- According to **Monique Zmuda**, deputy city controller, “if supervisors impose the 6-to-1 pay ratio, a group that paid the city's minimum wage to a full-time employee could pay its executive director no more than \$144,000 in salary, not including benefits.”

Great Site for Discussion

- <http://www.nonprofitlawblog.com/home/>

Potential Conflicts (Duty of Loyalty)

- Loans to and from disqualified persons including exec director
 - Even if at fair market value
- Hiring an investment manager that serves on the board, by definition, is a potential conflict
- **University of Texas Investment Management Company, the \$18.6 billion fundraising arm of the University of Texas, has found itself under increased scrutiny after looking to change its conflict of interest policy to allow greater leniency in its board members' investments. The current policy put in place eight years ago states that neither UTIMCO nor its board, as individual stock holders, can invest in any fund or partnership in which the other was investing. UTIMCO made a recommendation at the University of Texas System regents meeting that took place in May to rescind this rule and revert to the prior policy in place, although no decision was made, according to meeting documents. The previous policy stated UTIMCO was not allowed to invest in any funds, partnerships or companies of which a board member owned more than 5%.**

Due Care

- Read your conflict of interest policy before each board meeting
- **Full Disclosure to the board** – Since most of situations arise when only a **couple** of people in an organization know, full disclosure can establish good faith among boards.
- **Compensation** – If a **board member is compensated in any way by a nonprofit**, make sure their pay is either fair market value or less, a common mistake among boards.

Maryland Sales Tax

- Concessions
- Merchandise Sales
- Just because you buy from a nonprofit, doesn't make the transaction exempt from sales tax

What should be allowable?

- Almost 88 percent of overall nonprofit revenues in 2005, the most recent year for which figures are available, came from fees for services, sales and sources other than charitable contributions...Nonprofit health care providers, day care centers and retirement homes, among others, are often difficult to distinguish from their tax-paying competitors.
- The Mall of America, a major tourist attraction, was seeking tax exemptions as part of its plans to expand, arguing that it aids the state economy by drawing visitors.

UBIT (990-T)

- It is a trade or business,
- It is regularly carried on, and
- It is not substantially related to furthering the exempt purpose of the organization.

Specific Exemptions

- **Volunteer Labor:** Any trade or business is excluded in which substantially all the work is performed for the organization without compensation. Some fundraising activities, such as volunteer operated bake sales, may meet this exception.
- **Convenience of Members:** Any trade or business is excluded that is carried on by an organization described in section 501(c)(3) or by a governmental college or university primarily for the convenience of its members, students, patients, officers, or employees. A typical example of this is a school cafeteria.
- **Selling Donated Merchandise:** Any trade or business is excluded that consists of selling merchandise, substantially all of which the organization received as gifts or contributions. Many thrift shop operations of exempt organizations would meet this exception.

Stay Out of Trouble

- A business activity is not substantially related to an organization's exempt purpose *if it does not contribute importantly* to accomplishing that purpose (other than through the production of funds). Whether an activity contributes importantly depends in each case on the facts involved. In determining whether activities contribute importantly to the accomplishment of an exempt purpose, the size and extent of the activities involved must be considered in relation to the nature and extent of the exempt function that they intend to serve. For example, to the extent an activity is conducted on a scale larger than is reasonably necessary to perform an exempt purpose, it does not contribute importantly to the accomplishment of the exempt purpose. The part of the activity that is more than needed to accomplish the exempt purpose is an unrelated trade or business.

Quiz/Discussion

- Ballet School Spring Carnival
 - Volunteer labor exemption
- Ballet School Shows the Movie “Kung Fu Panda” and charges admission. Pays royalties to the movie company.
- What if royalty fee is donated to the organization?

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