



ARE YOU READY?



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Agenda

Welcome

FIN 48 Discussion

FSP FAS 117-1 Discussion

FIN 48 Agenda

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Summary

Objective and Scope

FASB 109, Accounting for Income Taxes

- **Issued February 1992**
- **Codified in 2008**
 - FASB ASC 450, Contingencies
 - FASB ASC 740, Income Taxes

FIN 48, *Accounting for Uncertainty in Income Taxes*

- **Issued June 2006**
- **Interprets and clarifies accounting for uncertain tax positions**
- **Effective for the majority of Nonprofit Organizations with year ends beginning on or after December 15, 2008**
 - (Generally the 2009 Audited Financial Statements)

Objective and Scope

Assumptions

- **ALL income tax returns will be examined by the appropriate taxing authorities**
- **The examiners will have a thorough knowledge of all the facts and circumstances regarding the tax returns.**

Considerations

- **Likelihood of a tax liability being assessed**
- **A liability must be recorded for taxes with a greater than 50% chance of being assessed by the taxing authorities.**

No further guidance has been issued by FASB

Application to Nonprofit Organizations



***“This should be easy!
Our organization is tax exempt.
Therefore we don’t have any tax positions.
FIN 48 doesn’t apply to us.”***

FASB did NOT exclude tax-exempt organizations from the scope of FIN 48.

Four Tax Positions Nonprofit Organizations Regularly Take

- **The organization is exempt from federal income tax**
- **None of the organization’s revenue is unrelated business income**
- **The organization does have unrelated business income, but offset by related expenses**
- **Filing/Nonfiling of State Returns**

Tax Positions - Issues to Consider

Issue #1 – Tax-Exempt Status

- **Exempt under correct classification**
- **Analyze current activities**
 - Organizational and Operational Test
 - Revenue and Expenditures consistent with IRS Application
 - Notification of changes in activity
- **Private inurement, private benefit**
- **Self dealing**

Tax Positions - Issues to Consider

Issue #1 – Tax-Exempt Status

- **Reportable transactions**
- **Excess lobbying**
- **Political intervention**
- **Compliance with filing Requirements**
 - 8282 and 8283
 - 1098 and 1099
 - 941

Tax Positions - Issues to Consider

Issue #2 – Unrelated Business Income (UBI)

- **Analyze Revenue Streams**
- **Identify Authority**
 - Internal Revenue Code
 - Treasury Regulations
 - Court Cases
 - Revenue Rulings, Revenue Procedures
 - Tax Treaties
 - PLRs, TAMs, AODs, GCMs, IRM, Internal Revenue Bulletin
- **Consider size, scope, facts and circumstances**

Tax Positions - Issues to Consider

Issue #2 – Unrelated Business Income

▪ Potential sources of UBI

- Trade or business, regularly carried on, unrelated to exempt purpose
- Income from Partnerships, S Corporations
- Debt financed income
- Income from controlled organizations
- Exploiting an exempt activity
- Advertising
- Management services

Tax Positions - Issues to Consider

Issue #3 – Unrelated Business Income Expenses

▪ Direct Expenses

- Ordinary and Necessary
- Subject to rules regarding related party transactions, UNICAP, meals and entertainment, fines and penalties, depreciation

▪ Indirect Expenses

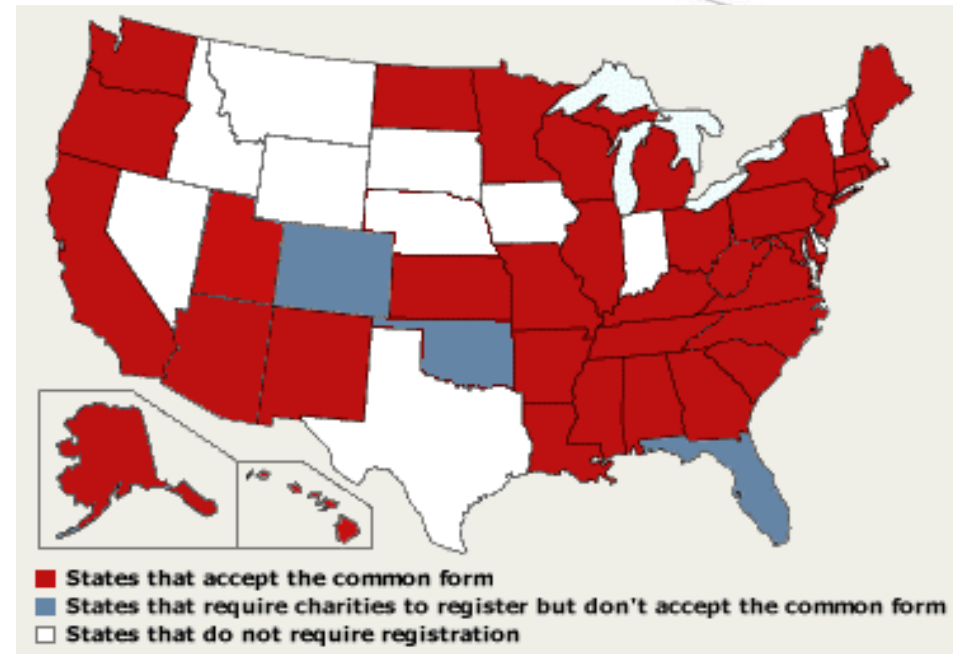
- Allocation of “dual use” facilities and personnel
- Charitable contributions
- Utilization of prior years’ NOL

Tax Positions - Issues to Consider



Issue #4 – State Filing Requirements

- **Exempt Activity**
 - Registration
 - Annual filing
- **Unrelated Business Income**
 - Determining nexus
 - Statute of limitations



Action Steps

Determine the level of materiality.

Identify open tax years.

Develop a complete inventory of tax positions taken.

- **Application for tax-exemption and any related correspondence to and from the IRS for consistency with current operating activities.**
- **All sources of revenue, including underlying investments, on each tax filing in all significant jurisdictions**
- **Activities, including those by volunteers and board members**
- **Financial statements and trial balances for all legal entities**
- **Minutes from all Board of Directors and committee meetings**

Action Steps

Develop a complete inventory of tax positions taken.

- **Transactions with officers, directors and significant influencers of the organization, consistency with the organizations' tax-exempt status**
- **Net operating losses (NOLs)**
- **State nexus**
- **Results of prior income tax audits**

Understand what is necessary to reach a “more likely than not” level of comfort with the tax positions taken.

Recognition and Measurement

“More Likely Than Not”

What is the likelihood that an examining agent, in possession of all the facts, would sustain this tax position?

- **> 50%, tax position is not considered to be uncertain**
 - Tax benefits of the position will be recognized (100%)
 - FIN 48 accounting and reporting provisions do not apply
- **≤50%, tax position is uncertain**
 - Tax benefits of the position will not be recognized (0%)
 - A liability will be recorded
 - “Unit of account” detail must be considered

Recognition and Measurement

“More Likely Than Not”

Example: Unrelated business activities include some that generate taxable income and others that generate a tax loss, resulting in no net taxable income. If each of the activities is a “unit of account”, each must be analyzed separately.

If the activity generating income is certain while the activity generating a loss is uncertain, the organization must consider recording a tax liability for the benefit claimed by the loss activity.

Recognition and Measurement

Materiality

- **The importance and significance of an amount, transaction, or discrepancy**
- **Auditors only address incorrectly recorded items that are above a pre-established level of importance**
- **FASB has not issued quantitative guidelines**

Recognition and Measurement

Categories:

- **Highly Certain (virtually no tax risk)**
- **Uncertain (along with its level of certainty)**
- **Immaterial**

List the rationale/substantial tax authority for each position

Subjectivity

Few precedents, limited guidance

Adoption of FIN 48

- Footnote disclosure required.
- Disclosure of FIN 48 impact upon adoption and detail changes to the FIN 48 reserve required.
- Changes in net assets accounted for as adjustment to the opening net asset balance.
- Form 990 now requires FIN 48 footnote text to be included in the form.

Adoption of FIN 48

Begin Now!

- **Expect memo request from financial statement auditors.**
- **In some cases, a memo outlining such risk areas will need further documentation.**
- **Independence considerations may affect assistance that audit team may render directly.**
- **Tax team may be engaged to draft memo analyzing all tax positions for management use.**

Summary

Four Tax Positions Nonprofit Organizations Regularly Take

- **Exempt Status**
- **Unrelated business income**
- **Unrelated business income expenses**
- **Filing/Nonfiling of State Returns**

Continuous Monitoring

- **Tax law changes**
- **New interpretations of the law**
- **Changes in facts and circumstances**

Be prepared to give your organization's activity a fresh evaluation.

Organizations in compliance will find themselves well prepared for IRS examination or other scrutiny that may arise.



FSP FAS 117-1:

Endowments of Not-for-Profit Organizations - Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds

FSP FAS 117-1 Agenda

Objectives

Definitions of Key Terms

UPMIFA and Its Effects

Disclosure Considerations

FSP FAS 117-1

Objectives

- **Provide guidance on net asset classification of donor-restricted endowment funds for not-for-profit organizations subject to UPMIFA .**
- **Improve disclosures about an organization's endowment funds (both donor-restricted and board-designated), whether or not the organization is subject to UPMIFA.**

Effective date: Effective for fiscal years ending after December 31, 2008.

Key Terms - Endowment

An established fund of cash, securities or other net assets to provide income for the maintenance of a not-for-profit organization.

- **Permanently restricted**
- **Temporarily restricted**
- **Unrestricted**

Two Types of Endowments

- **Permanent endowment – established to provide a permanent source of income**
- **Term endowment – established to provide income over a specified period of time**

Other Key Terms

- **Unrestricted net assets – net assets that are not subject to donor-imposed restrictions.**
 - **Board-designated net assets – are a part of unrestricted net assets that result from an internal designation.**
- **Temporarily restricted net assets – net assets subject to donor-imposed restrictions that can be removed by the passage of time or the actions of management.**
- **Permanently restricted net assets – net assets subject to donor-imposed restrictions that can never be removed.**

UPMIFA

What is UPMIFA?

- **The Uniform Prudent Management of Institutional Funds Act of 2006.**
- **A model act that serves as the basis for state-by-state legislation.**
- **An overhaul / modernization of the Uniform Management of Institutional Funds Act of 1972, which has/had been the basis for primary endowment laws in 47 states and the District of Columbia. As of September 1, 2009, Pennsylvania, Louisiana and Florida have not adopted UPMIFA.**

Net Asset Classification with UPMIFA

- Net asset classification is done fund-by-fund and then aggregated: a “cross section” through the institution’s equity.
- Historic dollar value (HDV) portion of fund is classified as permanently restricted net assets.
- Portion of each fund in excess of HDV:
 - **Additional amounts a governing board determines that the law requires to be retained permanently are also classified as permanently restricted net assets.**
 - **Remainder of fund is classified as temporarily restricted or unrestricted net assets.**
- Losses that bring the value of the fund below HDV are charged to temporarily restricted or unrestricted net assets.
- Unless maintenance of purchasing power is required by either the donor or the state’s UPMIFA, the amount classified as permanently restricted net assets for a particular fund does not change from year to year.

Net Asset Classification with UPMIFA: What Has Not Changed?

Permanently restricted net assets are not diminished by investment losses or organizational appropriations for spending.

- **Rationale: The organization's permanent fiduciary duty for a fund of permanent duration is unchanged.**
- **(Short-term) funding / cash management flexibility for legal purposes versus net asset classification for financial reporting purposes.**

Instead, temporarily restricted net assets or unrestricted net assets would be charged. That charge is within the endowment, not within operating funds.

Net Asset Classification with UPMIFA: What Has Changed?



- UPMIFA applies a time restriction until funds are appropriated.
- Amounts in excess of the portion classified as permanently restricted will be classified entirely as temporarily restricted.
- The only balances in donor endowments that will be classified as unrestricted are negative balances in underwater situations.

Net Asset Classification with UPMIFA: The Time Restriction



- The time restriction lapses upon appropriation.
- For funds without purpose restrictions, reclassification to unrestricted occurs at that time.
- For funds with purpose restrictions, reclassification can only happen when funds are spent or deemed spent for that purpose.
- Purpose restrictions cannot be released until amounts are appropriated: the “deemed spent” rule will no longer apply to unappropriated amounts.

FSP FAS 117-1: Disclosure Requirements



- A not-for-profit organization shall disclose information to enable users to understand the net asset classification, net asset composition, changes in net asset composition, spending policy(ies), and related investment policy(ies) concerning its endowment funds (both board-designated and donor-restricted).
- Applies to all organizations with endowments, not just those subject to UPMIFA.

FSP FAS 117-1: Disclosures

- Description of governing board's interpretation of relevant law underlying net asset classification.
- Description of endowment spending (distribution) policy(ies).
- Description of endowment investment policy(ies).
 - **Return objectives and risk parameters**
 - **How the objectives relate to spending policy(ies)**
 - **Strategies for achieving objectives**
- **Composition of endowment by net asset class.**
- **Endowment roll-forward by net asset class.**



Nonprofit Organizations

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