



Non-Profit Organizations Core Fundamentals

April 1, 2011

David Trimner, Tax Partner

Agenda



Session	Time
Nonprofit Organization Basics	75 mins.
Unrelated Business Income	75 mins.
Good Governance	30 mins.
ASC 740-10 for Nonprofits	10 mins.
Questions	10 mins.
TOTAL	200 mins.

Objectives

At the end of this session, you will be able to:

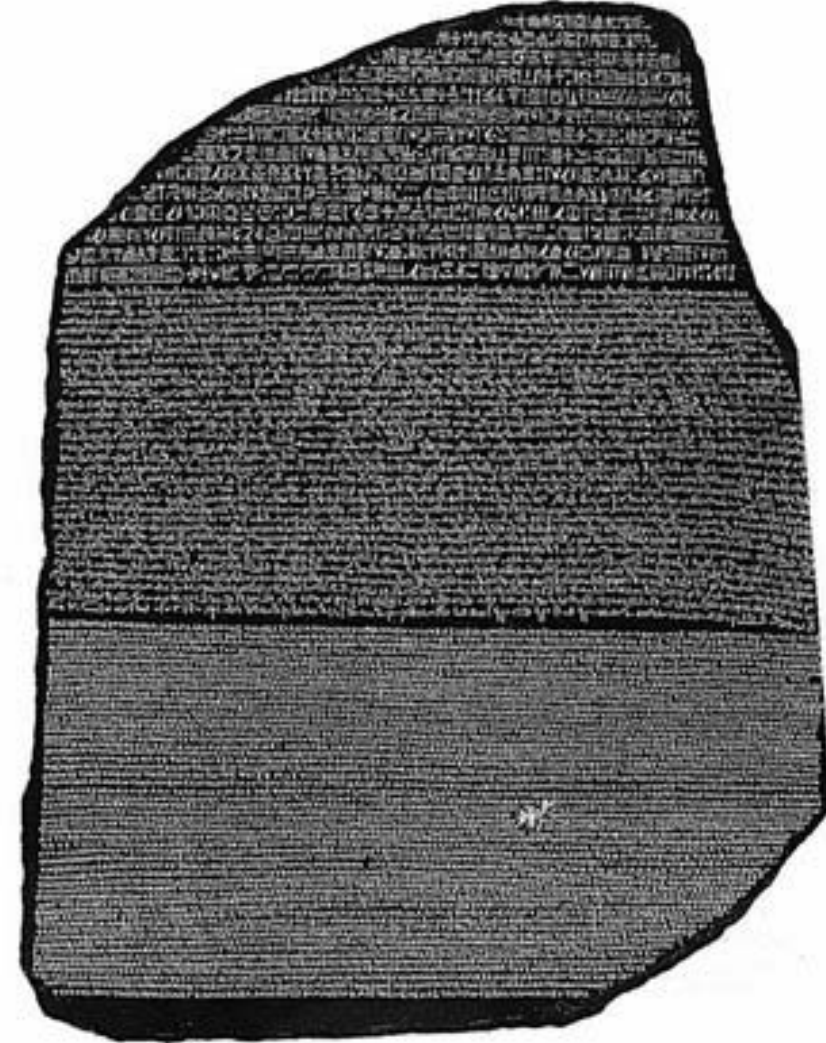
- **Identify various types of nonprofit organizations**
- **Understand the various types of support that public charities receive**
- **Identify the 3 tests for unrelated business income, and recognize important exceptions**
- **Understand the best practices and policies for well-governed nonprofit organizations**
- **Appreciate how accounting for uncertainty in income taxes affects tax-exempt organizations**



Non-Profit Organization Basics



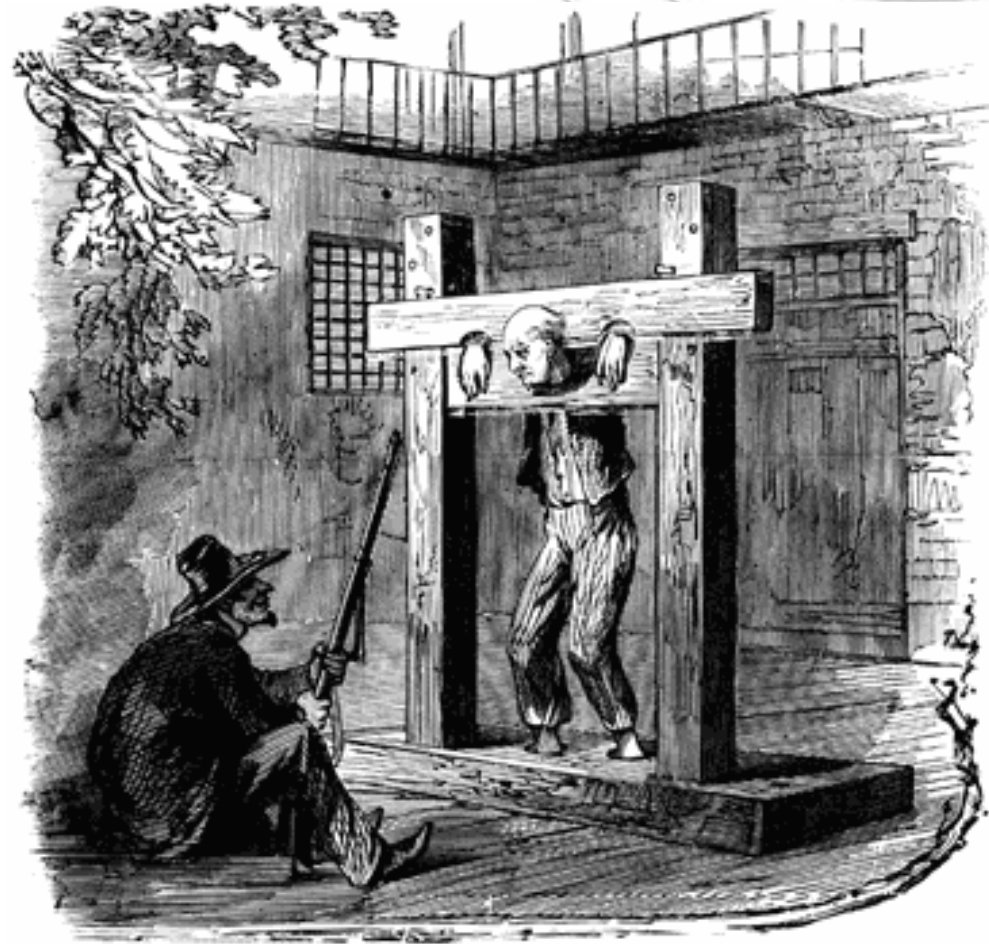
Introduction



Introduction

Concept of charity

- **Historical Considerations**
British Common Law
- **Private Inurement**
Private Benefit
- **Public Policy**
Reducing the burden of government
- **Constitutional Protections**
and Freedoms of religion and association



Introduction



PHILANTHROPIST	SPAN OF GIVING	AMOUNT	IN CURRENT DOLLARS
Andrew Carnegie	1902-1919	\$350M	\$7.2B
John D. Rockefeller	1889-1937	\$530M	\$7.1B
John D. Rockefeller Jr.	1927-1960	\$475M	\$5.5B

Introduction

Exempt organizations are under scrutiny!

Scrutiny by whom?

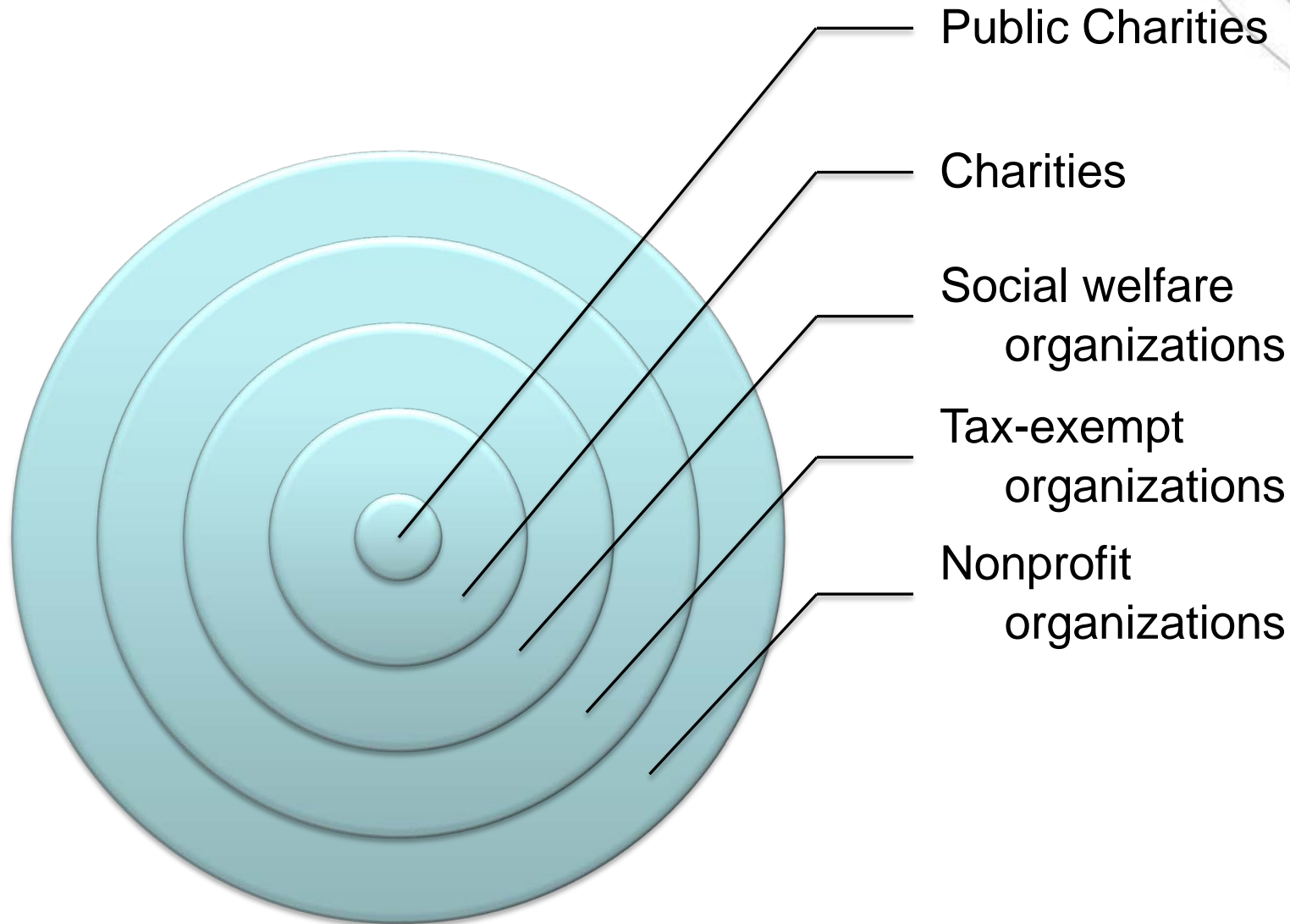
- **IRS and Treasury**
- **Congress, Senate Finance Committee, House Ways & Means Committee**
- **States' attorneys general**
- **Media**
- **Donors**
- **Unions**
- **Whistleblowers**

Introduction

Why the scrutiny?

- **Perception of abuses by exempt organizations**
- **Tough economy and searching for additional sources of tax revenue**
- **Perceived need for closer oversight of exempt organizations**
- **Decline in public confidence**
- **Prohibited political activity**
- **Excessive executive compensation**

Tax-Exempt Organizations



Tax-Exempt Organizations

Advantages

- **Exempt from Federal corporate income tax, and (FUTA) for section 501(c)(3) organizations**
- **Contributions are deductible from donors' income**
- **Exemption from state/local income and franchise tax, state/local sales and use tax, state/local property tax.**
- **Finance capital projects using tax-exempt bond proceeds.**
- **Reduced U.S. postage rates.**

Tax-Exempt Organizations

Disadvantages

- **Limitations on lobbying and political activities**
- **Restrictions on the use and distribution of assets**
- **Significant compliance and reporting requirements subject to public disclosure**
- **Public scrutiny of operations including executive compensation**
- **Penalties (excise taxes) for noncompliance**

Tax-Exempt Organizations

Categories

- **Charitable orgs. – Sec. 501(c)(3)**
- **Social welfare orgs. – Sec. 501(c)(4)**
- **Labor, agricultural & horticultural orgs. – Sec. 501(c)(5)**
- **Business leagues & chambers of commerce – Sec. 501(c)(6)**
- **Social clubs – Sec. 501(c)(7)**
- **Fraternal societies – Sec. 501(c)(8)**
- **Voluntary employees' beneficiary associations – Sec. 501(c)(9)**
- **Title holding companies – Secs. 501(c)(2) & 501(c)(25)**
- **Political organizations – Sec. 527**

Charitable Organizations

Sec. 501(c)(3)

Statutory Definition

- **Corporations, community chests, funds, or foundations organized and operated exclusively for charitable, religious, educational, scientific, literary, or for testing for public safety.**
- **No part of the net earnings of which inures to the benefit of any private shareholder or individual.**
- **No substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation.**
- **Does not participate in, or intervene in any political campaign on behalf of (or in opposition to) any candidate for public office.**

Charitable Organizations

Sec. 501(c)(3)

Organizational Test

- **Form 1023**
- **Exceptions:**
 - **Churches**
 - **Any organization (other than a private foundation) normally having annual gross receipts < \$5,000**
- **IRS determination letter effective from date of formation**

Charitable Organizations

Sec. 501(c)(3)

Organizational Test

- **Organized exclusively for exempt purposes, specifically stated in the Articles of Incorporation**
- **Limits lobbying activity, prohibits political campaign intervention**
- **Assets dedicated to exempt purpose, distribution of assets at dissolution must be to another charitable organization**
- **Treas. Reg. 1.501(c)(3)-1(b)**

Charitable Organizations

Sec. 501(c)(3)

Operational Test

- **Must operate continuously in furtherance of its exempt purpose**
- **No private inurement**
- **Hospitals and healthcare organizations must operate for the benefit of the community**
- **Lobbying activity judged subjectively or objectively**
- **Treas. Reg. 1.501(c)(3)-1(c)**

Charitable Organizations

Reg. 1.509(a)-1

A charity is a private foundation except when it isn't

- **Section 509(a)(1) – Churches, schools, hospitals, and publicly supported organizations**
- **Section 509(a)(2) – Publicly supported organizations with exempt function income, limits on investment income**
- **Section 509(a)(3) – Supporting organization**
- **Section 509(a)(4) – Testing for public safety**



Charitable Organizations

Section 509(a)(1)



Section 509(a)(1)

Churches, associations of churches, and religious organizations
Educational organizations
Hospitals and research organizations
Governmental units

Publicly Supported Organizations

One Third Public Support Test

Facts and Circumstances Test

- Continuous solicitation.
- Community representation on Board
- Continuous public benefit
- Membership dues

- Receives at least 1/3 of its total support as contributions from the general public.
- “Normally” is defined as the aggregate total support for the 5 most recent tax years.
- Contributions count as public support to the extent they don’t exceed 2% of total support.
- 2% test not applicable to grants from publicly supported charities and governmental units.

Charitable Organizations

Section 509(a)(2)

Support Test

- **At least 1/3 of its total support as contributions or “exempt function” income**
 - **No excess contributions or substantial contributors.**
- **Receives no more than 1/3 of its total support as investment income and unrelated business taxable income**



Charitable Organizations

Section 509(a)(3)



Supporting Organizations

- **Organized and at all times thereafter operated exclusively for the benefit of, to perform functions of, or to carry out the purposes of one or more specified organizations described in section 509(a)(1) or 509(a)(2).**
- **Must be operated, supervised, or controlled by or in connection with one or more organizations described in section 509(a)(1) or 509(a)(2).**
- **Must not be controlled directly or indirectly by disqualified persons (other than foundation managers and section 509(a)(1) or 509(a)(2) organization(s) which it supports).**
- **No public support or facts and circumstances tests**

Private Foundations

Conceptual Definition

***A nongovernmental, nonprofit organization
with its own funds (usually from a single source) and
programs,
managed by its own trustees and directors,
established to maintain or aid educational, social, charitable,
religious, or other activities serving the common
welfare,
primarily by making grants to other nonprofit organizations.***

Private Foundations

Technical Definition

A domestic or foreign organization

described in IRC § 501(c),

*other than an organization described in IRC §
509(a)(1),(2),(3),(4).*

- Not a church
- Not a school
- Not a hospital
- Not a research organization
- Not a public charity
- Not a service charity
- Not a supporting organization
- Not testing for public safety

Private Foundations

Public Charity or Private Foundation?

- **Funding sources**
- **Filing Exemption**
- **Disclosure of Investments and Investment Income**
- **Public Disclosure of Donors**
- **Direct Charitable Activities**
- **Basis/Gain for Noncash Contributions**
- **Taxes**



Private Foundations

Nonoperating Foundation

- **Makes grants to other charitable organizations who provide the charitable services to the public**
- **May also operate some of its own programs**

Operating Foundation

- **Primarily directly carries out its own charitable programs**
- **Makes limited grants**
- **Subject to Income Test**
- **Subject to either Assets, Endowment, or Support Test**
- **IRC § 4942(j)(3)**

Excise Taxes

**Section 4940
Net Investment Income**

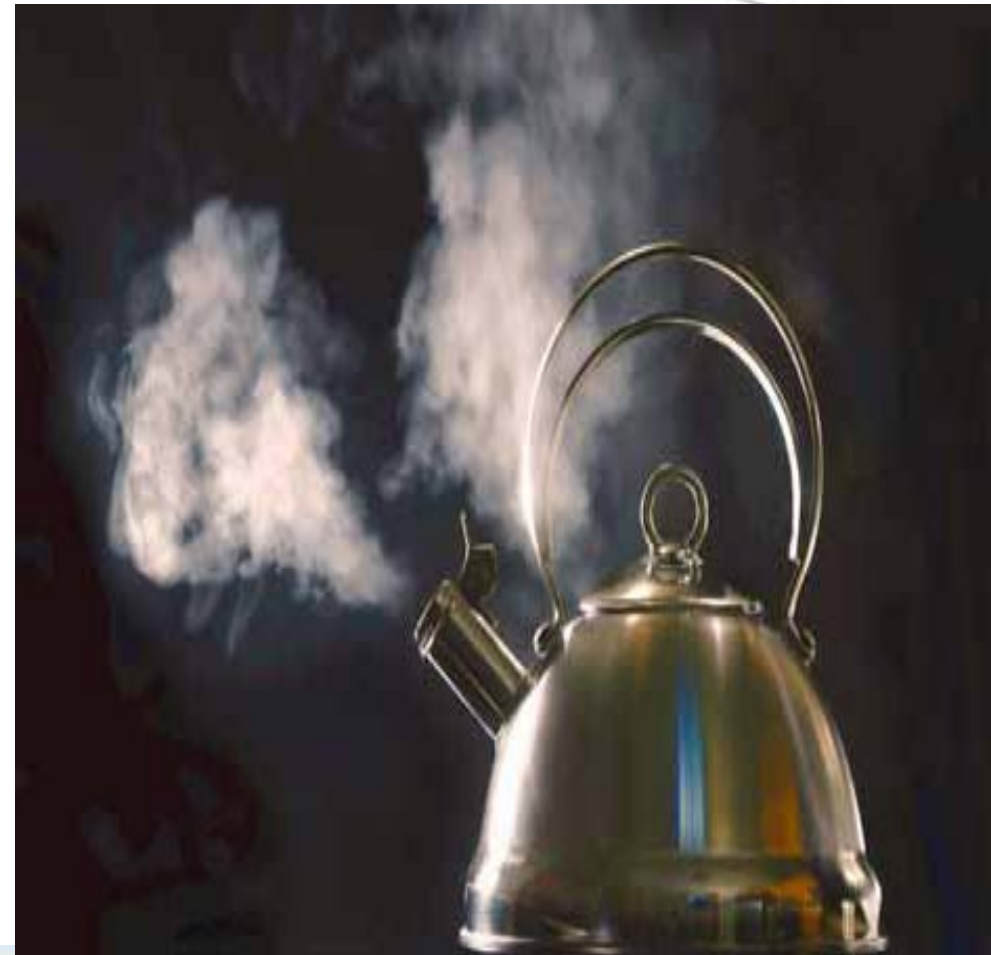
**Section 4941
Self Dealing**

**Section 4942
Failure To Distribute Income**

**Section 4943
Excess Business Holdings**

**Section 4944
Jeopardizing Investments**

**Section 4945
Taxable Expenditures**

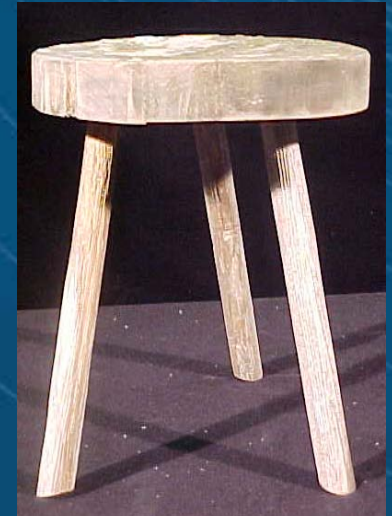


Donor considerations

1. Contributions to foundations are subject 30% limit (not 50%)
2. Long term appreciated stocks get the deduction equal to the FMV (20% limit)
3. Foundation can be subject to state registration requirements if “founder” solicits donations
4. Expenses paid personally on behalf of the foundation can be charitable contributions
5. Can't use foundation assets to satisfy a pledge in the donor's name – excise tax for “self dealing”



Unrelated Business Income

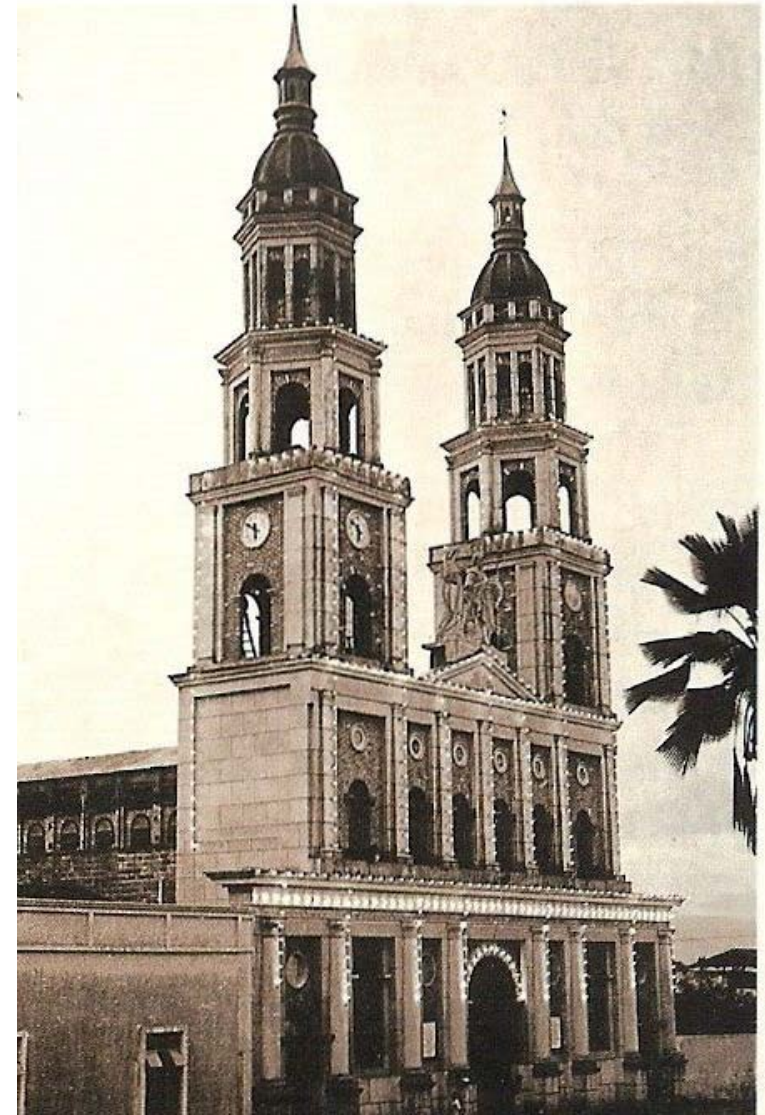


Unrelated Business Income

What's Wrong with Making a Profit?

- **Unrelated Business Income is taxed @ corporate rates (avg. 40% blended Fed & State), leaving the organization with roughly 60% of after-tax profits.**
- **Alternative Revenue Generating Activities, in aggregate, should not become a substantial part of the organization's activity.**
- **Understanding the tax consequences of proposed transactions help the organization make sound business decisions.**

Unrelated Business Income



Unrelated Business Income



Unrelated Business Income

Federal

- **Form 990-T, Unrelated Business Income Tax Return, when gross receipts from an unrelated business are \$1,000 or more**
- **Form 990-T is available for public inspection**

State

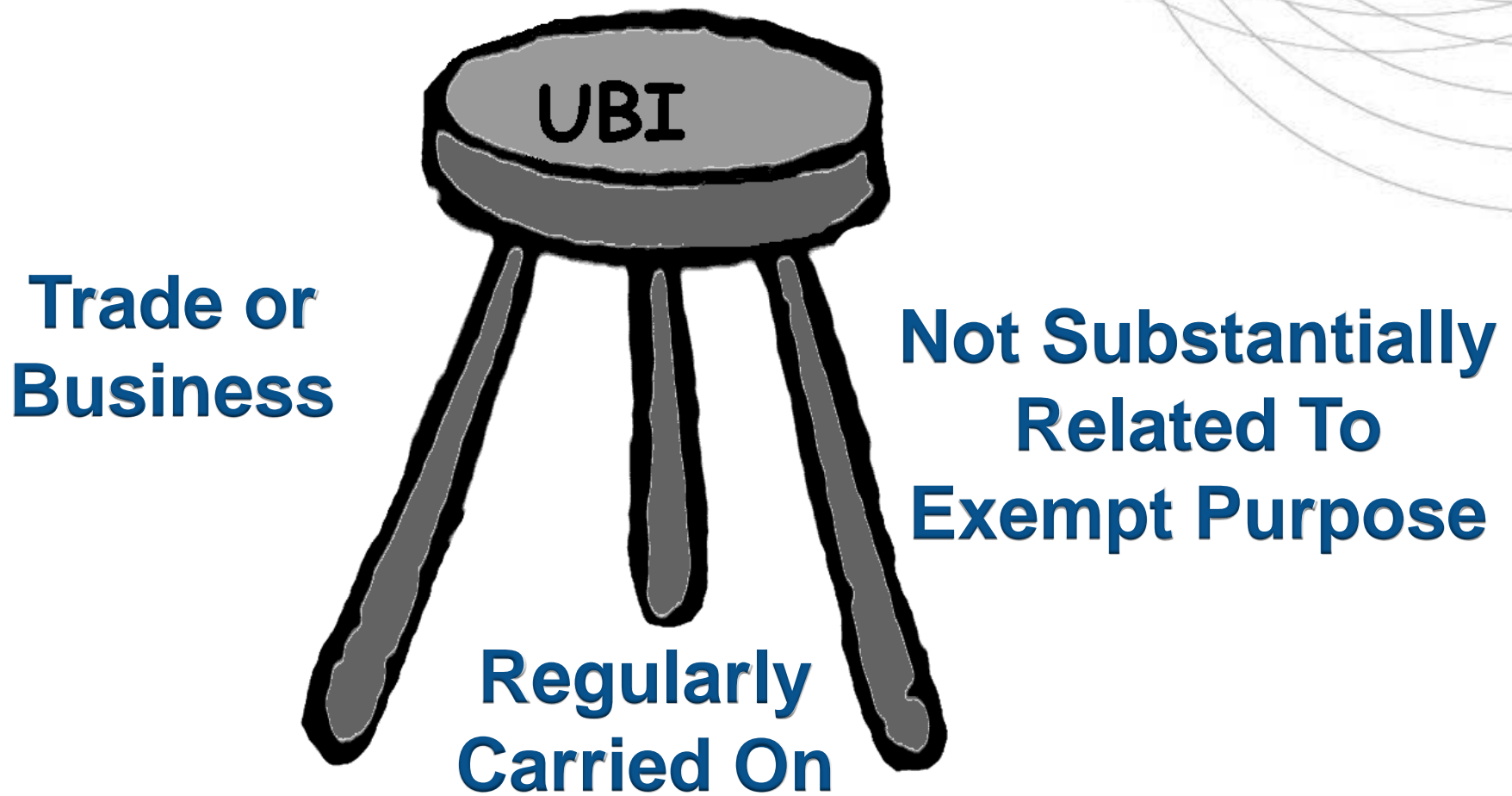
- **Certain states impose a tax on UBI generated**
- **Additional tax filings may be required**

Penalties

- **Failure to file**
- **Failure to pay estimated tax payments**
- **Late payment of tax**
- **Interest**



UBI Defined – IRC § 512(a)(1)



TRADE OR BUSINESS

Reg. §1.513-1(b)

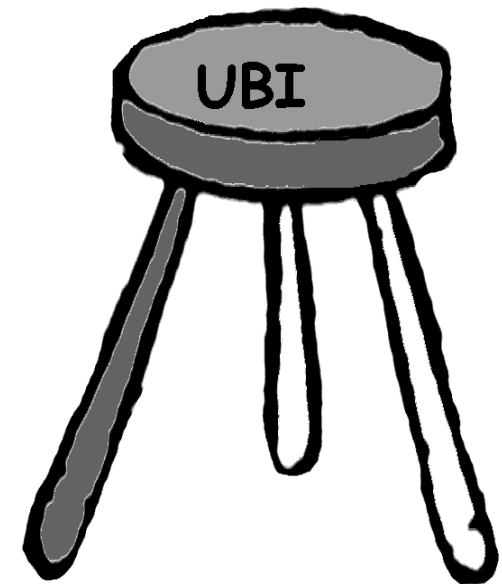
Any activity carried on for the production of income from the sale of goods or the performance of services.

Profit Motive Test

Unfair Competition Test

Commercial Manner Test

Extensive use of resources

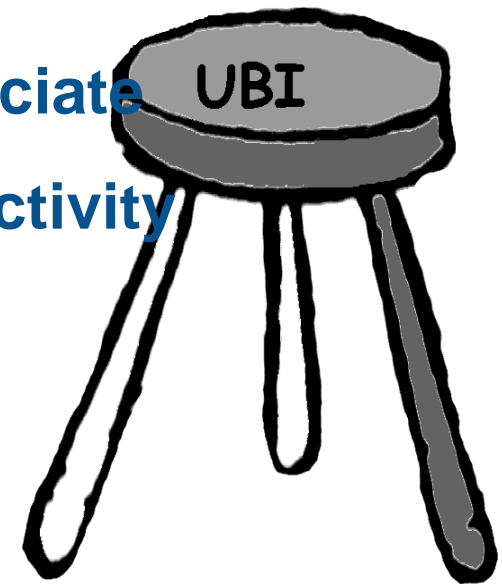


TRADE OR BUSINESS

Reg. §1.513-1(b)

Profit Motive Test – Reg. 1.183-2(b)

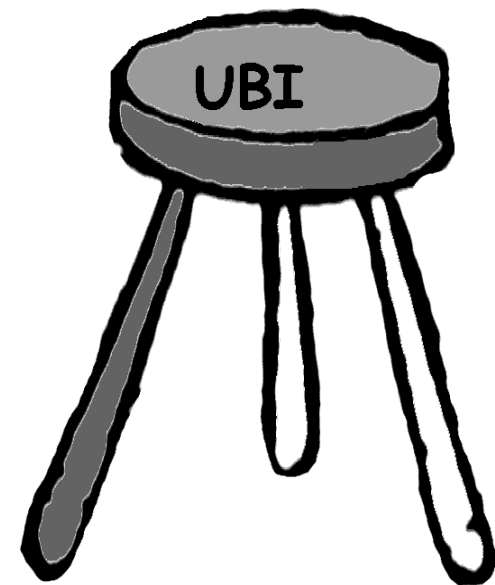
1. Manner in which the activity is carried on
2. Expertise of taxpayer and advisors
3. Time and effort expended
4. Expectation that activity assets will appreciate
5. Success experienced in carrying on the activity
6. History of income or losses
7. Amount of profit earned
8. Financial status of the taxpayer
9. Elements of personal pleasure or recreation



TRADE OR BUSINESS

Reg. §1.513-1(b)

A charitable organization publishes a monthly journal containing articles and material related to its exempt purpose as well as advertising. Ad rates are not always sufficient to offset direct and indirect costs, therefore the charity occasionally experiences a loss from the activity for the year.

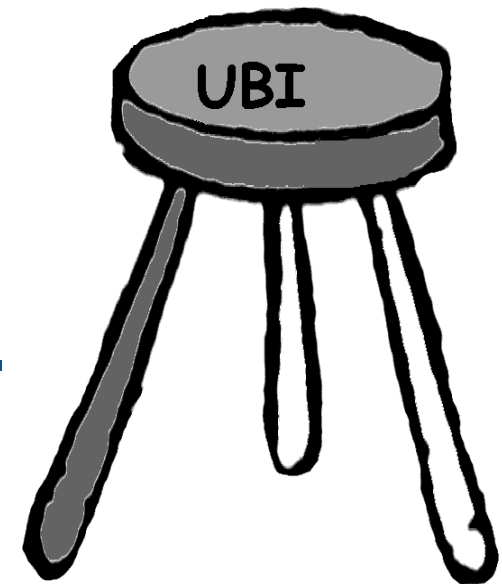


TRADE OR BUSINESS

Reg. §1.513-1(b)



A charitable organization publishes a monthly journal containing articles and material related to its exempt purpose as well as advertising. Ad rates are never sufficient to offset direct and indirect costs, therefore the charity has experienced a loss from the activity for the last 10 years.

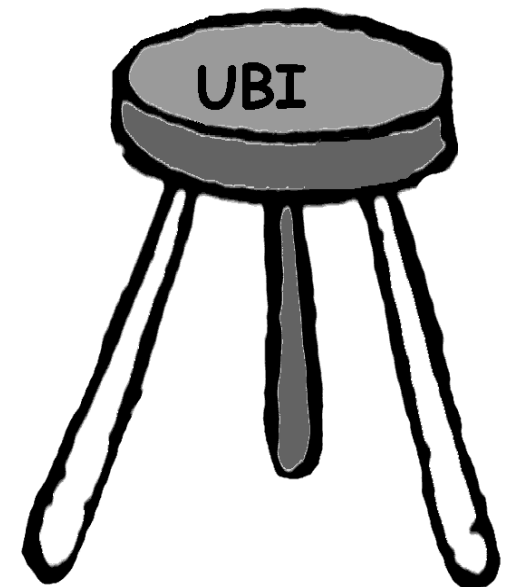


REGULARLY CARRIED ON

Reg. §1.513-1(c)

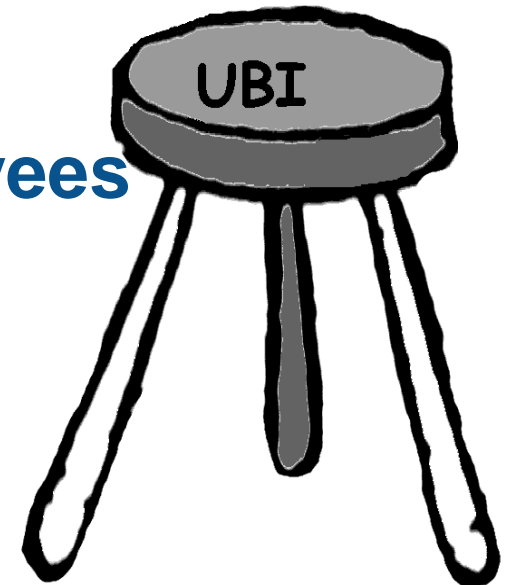
Is the activity's frequency, continuity and manner of conduct comparable to commercial operations of similar for-profit organizations?

- **Annually?**
- **Quarterly?**
- **Intermittently?**
- **Sporadically?**



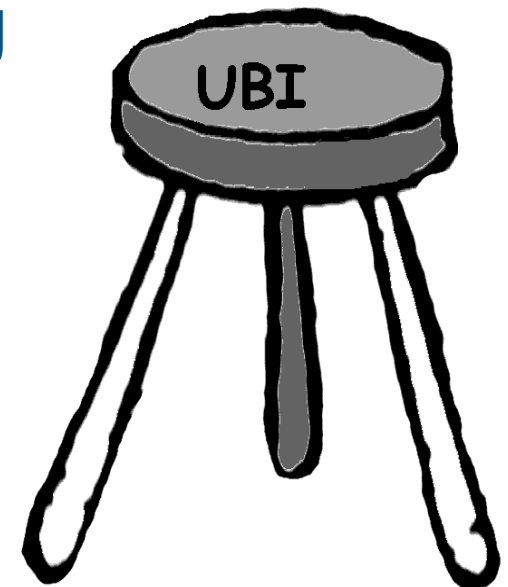
REGULARLY CARRIED ON Reg. §1.513-1(c)

A charitable organization with a mission of serving children and giving their issues a voice holds two conferences annually. At each conference a small booth displays & sells t-shirts, mugs, bags and other paraphernalia bearing the organization's name. The conference is attended by employees and other interested parties.



REGULARLY CARRIED ON Reg. §1.513-1(c)

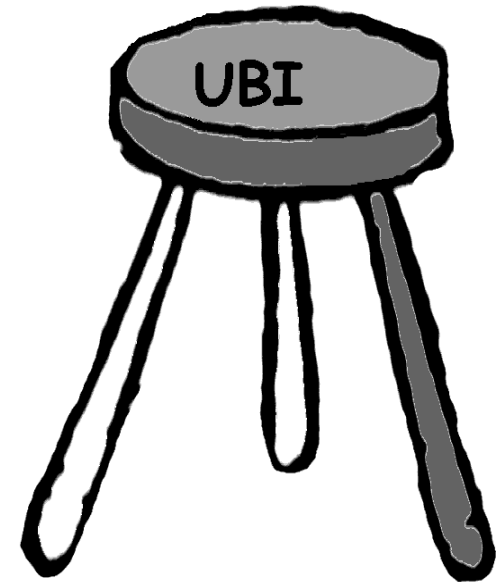
A charitable organization has an annual yearbook prepared and distributed to its entire membership. An independent commercial firm under contract throughout the year sells advertising space and collects advertising fees.



NOT SUBSTANTIALLY RELATED

Reg. §1.513-1(d)

- What is the relationship of the activity to the accomplishment of the exempt purpose (other than the destination of income)?
- What is the size and extent of the activity in relation to the nature and extent of the exempt function that they purport to serve? Is it excessive?

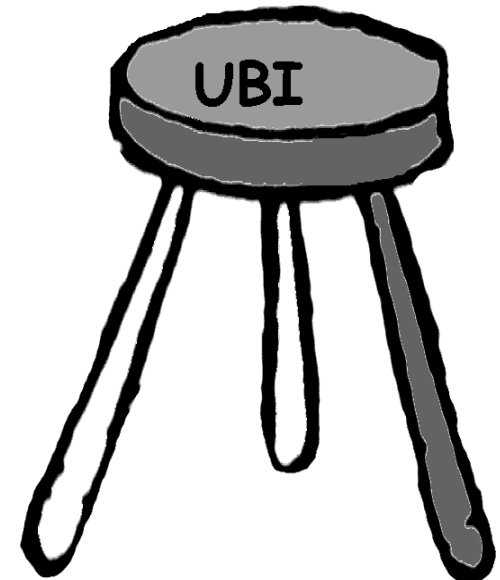


NOT SUBSTANTIALLY RELATED

Reg. §1.513-1(d)

The local Space Museum has a large movie theatre. It charges admission to visitors to see educational films about the Apollo moon landing.

The local Space Museum has a large movie theatre. It charges admission to visitors to see classic science fiction movies.

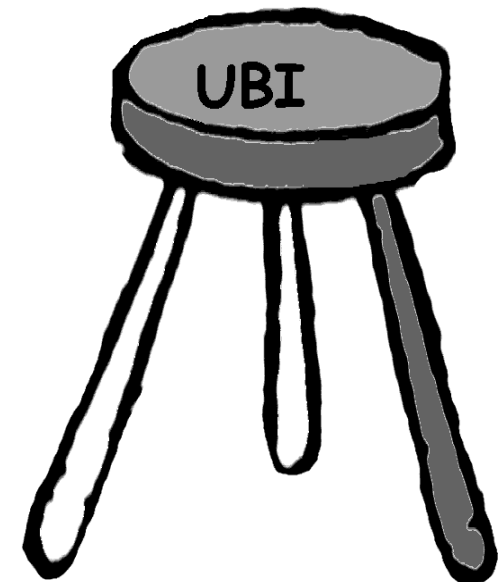


NOT SUBSTANTIALLY RELATED

Reg. §1.513-1(d)

A well-respected exempt scientific organization sells endorsements of manufacturers' products.

A well-respected exempt scientific organization receives payments for the use of its logo.

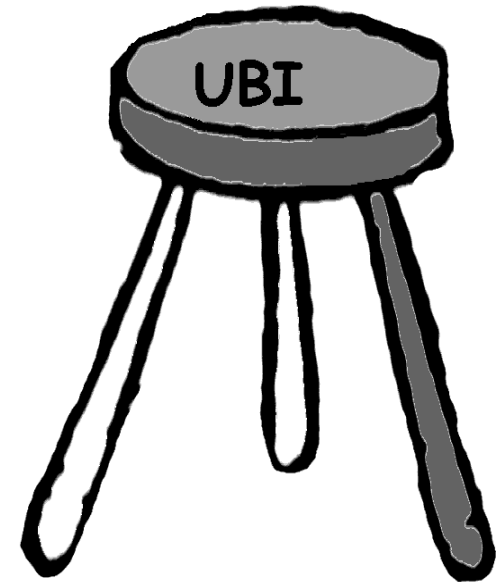


NOT SUBSTANTIALLY RELATED

Reg. §1.513-1(d)

Red State Zoo Gift Shop

1. T-shirts with animal pictures
2. T-shirts with animal pictures and a pamphlet describing the zoo's efforts to preserve that animal species and habitat
3. Postcards and calendars of zoo animals
4. Postcards of the Red State City skyline
5. Camera film and batteries
6. Newspapers
7. Snack bar
8. Sale of items on the website
9. Gift wrapping
10. Stuffed animals



NOT SUBSTANTIALLY RELATED

Reg. §1.513-1(d)

Advertising

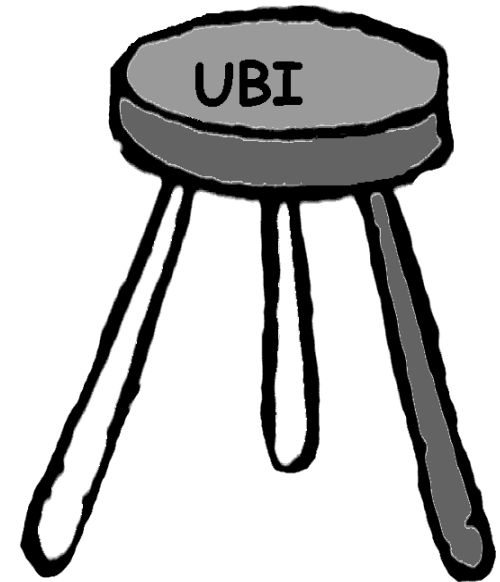
- A public charity produces a magazine containing paid advertising.
- The paid advertising contains no commercial message, merely lists the name of the purchaser.
- The paid advertising contains no commercial message, merely the name of the purchaser in blocked-in space.
- Instead of a public charity, the magazine is produced by a trade association.

NOT SUBSTANTIALLY RELATED

Reg. §1.513-1(d)

Qualified Sponsorship Payments

- **Substantial return benefit**
 1. **Advertising**
 2. **Exclusive provider arrangement**
 3. **Facilities, services, or privileges**
 4. **Right to use exempt organization's logo, trademark, patent, etc.**
 5. **Payments contingent on exposure**



NOT SUBSTANTIALLY RELATED

Reg. §1.513-1(d)

- **Qualified Sponsorship Payments**
 - **Charity M prints a monthly magazine. Corporation C purchases space for its name and logo, and simply states “Corporation C congratulates Charity M for the excellent work in this year’s Marathon”.**
 - **Blue State University receives a large donation from Sweetsie Cola, Inc. In return, BSU will name a writing competition after Sweetsie Cola, and will only sell Sweetsie Cola products on campus.**

NOT SUBSTANTIALLY RELATED

Reg. §1.513-1(d)

Advertising or QSP?

- **Charity M organizes a marathon, and serves refreshments donated by Corporation C. Corporation C also provides prizes with C's logo. Charity M prints flyers, banners, and posters for the event, prominently featuring C's logo. It renames the event "The Charity M ~ Corporation C Marathon".**
- **Same as above, except Corporation C stipulates that all items are a donation only if 1,000 or more people participate in the marathon.**

NOT SUBSTANTIALLY RELATED

Reg. §1.513-1(d)

Disposition - Reg. §1.513-1(d)(4)(ii)

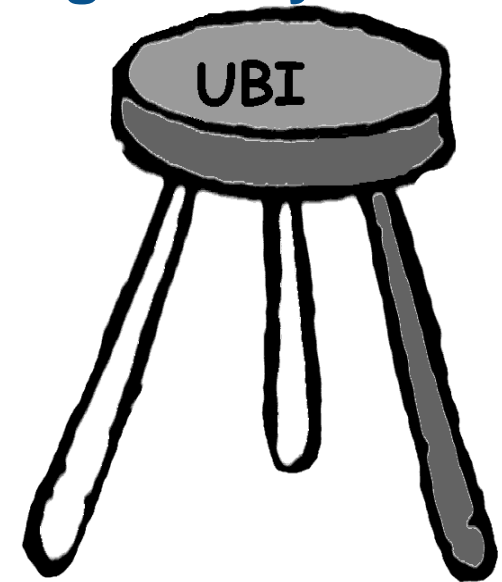
- **A blood bank collects and maintains inventories of human blood and blood products. Whole blood is separated into components, and much of the leftover plasma is sold to commercial laboratories.**
- **A blood bank purchases some plasma from other blood banks. This plasma is not used by the blood bank itself, but is sold to commercial laboratories.**

NOT SUBSTANTIALLY RELATED

Reg. §1.513-1(d)

Dual-use activities

- The exempt purpose of Charity X is to improve the quality of life for individuals suffering from Disease X.
 - Charity X maintains a vaccine manufacturing facility.
 - Facility manufactures vaccines to treat Disease X.
 - Facility also manufactures vaccines to treat Disease Y.

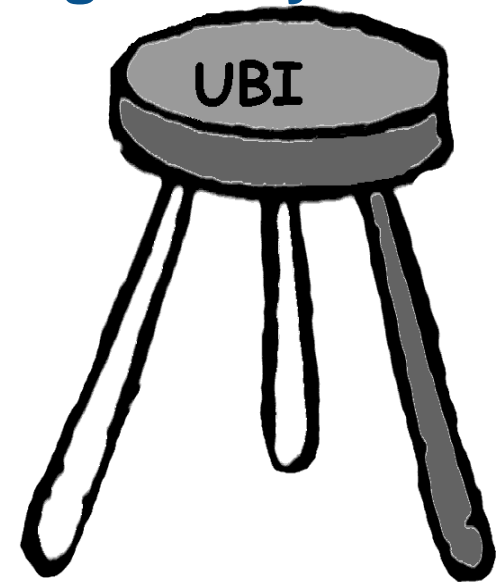


NOT SUBSTANTIALLY RELATED

Reg. §1.513-1(d)

Exploitation of an exempt activity

- The exempt purpose of Charity X is to improve the quality of life for individuals suffering from Disease X.
 - Charity X maintains a vaccine manufacturing facility.
 - Facility manufactures vaccines to treat Disease X.
 - Facility also manufactures vaccines to treat Disease Y.



NOT SUBSTANTIALLY RELATED

Reg. §1.513-1(d)

Travel Tours

- Relationship to the organization's exempt activity
- Use of qualified study leaders
- Organization contacts at tour location
- Relationship to lectures, classes, prior tours
- Educational content

Wassamatta U. Alumni Association operates a travel tour program open to current members and guests to encourage 'lifelong learning.' Faculty members often participate, but there is no curriculum or specialized instruction.

NOT SUBSTANTIALLY RELATED

Reg. §1.513-1(d)

Travel Tours

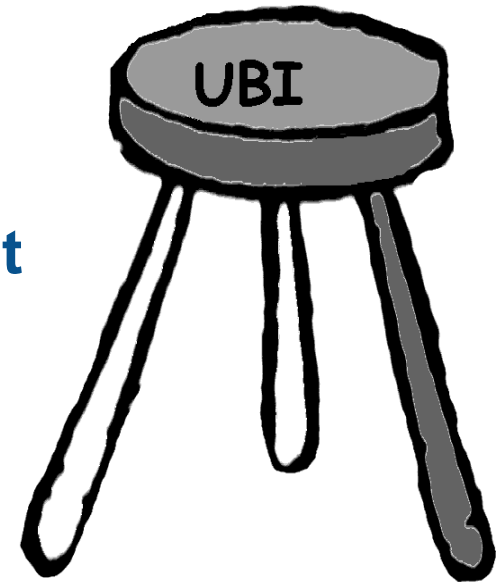
Charity G's exempt purpose is to educate the public about geography and culture, offering courses and publishing books. Charity G conducts tours to national parks across the USA conducted by university professors. The tour includes lectures, instruction, study, and writing assignments. Participation qualifies for academic credit.

C4 Social Welfare is devoted to advocacy on a particular issue. Regularly scheduled travel tours to Washington, DC are designed to allow members to attend meetings with legislators and officials and receive policy briefings. Evenings are free for recreation and sight seeing.

NOT SUBSTANTIALLY RELATED

Reg. §1.513-1(d)

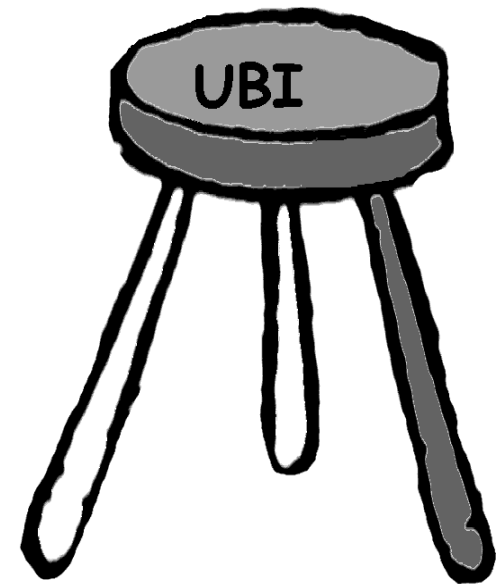
An Organization (whose purpose was to provide job training for unemployed residents) in a poor neighbourhood operated a food service business at prices substantially lower than those charged by competing grocery stores, provided free grocery delivery service to needy residents, and provided job training for unemployed residents. About four percent of the store's earnings is allocated for use in a continuous training program for the local chronically unemployed.



NOT SUBSTANTIALLY RELATED

Reg. §1.513-1(d)

Organization formed to provide therapy for emotionally disturbed adolescents operates a grocery store which employs therapy patients. The grocery store is operated at a level to utilize only the number of adolescents residing at the facility. The development of job skills is secondary to the goal of emotional rehabilitation of the adolescents through job satisfaction and personal achievement.



Exceptions

An exempt orphanage operates a retail store selling items to the general public.

An exempt orphanage operates a retail store selling items to the general public. All of the individuals carrying on the work are uncompensated.

An exempt orphanage operates a retail store selling items to the general public. Persons desiring to benefit the organization contribute used clothes, books, and furniture to be sold to benefit the orphanage.

Exceptions

An exempt assisted-living facility operates a laundry for the benefit of the residents.

A public charity receives “passive” investment income, including , dividends, interest, and royalty income.

A public charity receives interest on a loan to a controlled taxable subsidiary.

- **An exempt organization sells its mailing/membership list to unrelated entities.**
- **An exempt organization sells its mailing/membership list to unrelated entities and provides support services.**

Exceptions

A 501(c)(4) social welfare organization offers a monthly casino night, using paid volunteers.

A 501(c)(4) social welfare organization offers a monthly casino night, using unpaid volunteers.

A 501(c)(4) social welfare organization offers a monthly casino night, using unpaid volunteers who can receive tips.

A 501(c)(10) fraternal association offers a monthly casino night, using paid volunteers.

The only game is bingo.

The only game is “instant bingo” scratch-off cards.

Exceptions

University's School of Engineering conducts research projects for commercial companies on a contract basis. The research activity is unrelated to the exempt purpose of the University.

Charity R conducts research projects for commercial companies on a contract basis. The research activity is unrelated to the exempt purpose Charity R. The results of the research are timely and adequately made available to the general public.

Charity R conducts research projects for commercial companies on a contract basis. The research activity is unrelated to the exempt purpose Charity R. The research is performed for the State of Virginia.

Exceptions

An exempt organization rents out a large portion of its office building. It charges rent to tenants whose activities are unrelated the organization's exempt purpose.

There is a mortgage on the building.

The tenant occupies the first floor of a 12 story building.

Exceptions

Charity A is a 501(c)(6) trade association. A's mission includes supporting and enhancing activities within the industry, acting as a spokesperson for the industry, providing members with current information on technical developments, training methods, and economic issues, encouraging and fostering higher safety and technical standards, promoting technological advancements and improvements, and gathering and disseminating information about markets and products.

A conducts semi-annual trade shows to promote and stimulate demand for the products of A's industry. A plans and directs the show, secures the facility, charges admission, charges for rental of exhibitor space, and sells refreshments. There are educational seminars, and members and suppliers display products and services. Sales are permitted. Members, nonmembers, and potential customers attend the shows. Revenues from the shows are used to defray the shows' operating costs, and any net income is used in furtherance of A's exempt purposes.

Exceptions

Charity B is a 501(c)(6) trade association. B's mission includes supporting and enhancing activities within the industry, acting as a spokesperson for the industry, providing members with current information on technical developments, training methods, and economic issues, encouraging and fostering higher safety and technical standards, promoting technological advancements and improvements, and gathering and disseminating information about markets and products.

B has an Internet website available to the general public 24 hours a day, 7 days a week for two weeks, after which the website is removed. It does not overlap or coincide with any convention, annual meeting, or show conducted by B. The website permits members and the public to access information and visual displays, such as product directories and specific product listings, and contains links to the websites of B's members and suppliers. The website contains order forms, and allows on-line purchases from members and suppliers appearing. B charges a fee to those who wish to have information listed on the website.

UBIT Deductions

Allowable Deductions

- **Ordinary and necessary**
- **Proximate and primary relationship to the business activity**
- **Related Party Rules**
- **UNICAP**
- **Meals and Entertainment**
- **Fines and Penalties**
- **Excess readership costs**

UBIT Deductions

- **Charity X uses its auditorium for 160 days a year for exhibits and seminars related to its mission. 50 days a year, the auditorium is used for concerts, movies, and other activities unrelated to its mission.**

- **What portion of the indirect expenses of operating the auditorium are deductible?**
 - **50/210?**

 - **50/365?**

 - **Some other allocation entirely?**

Unrelated Business Income

Other Potential Sources of UBI

- **Investment in partnerships (LP, LLP, LLC, SMLLC)**
- **Alternative investments**
- **Corporate sponsorships**
- **Laboratory revenue**
- **Retail pharmacy**
- **Management services**
- **Gift shop**
- **Drug trials, clinical studies**
- **Fitness centers**
- **Parking Garage**
- **Cafeteria**

Unrelated Business Income

SPECIAL RULES

- **Social Clubs - IRC §501(c)(7)**
- **Voluntary employee benefit associations - IRC § 501(c)(9)**
- **Unemployment compensation trusts - IRC §501(c)(17)**
- **Group legal service organizations - IRC §501(c)(20)**



Good Governance



Introduction

*Good Policies don't create good governance,
Good people do.*

A highly effective and engaged Board of Directors can

- **Engage the Community**
- **Maintain the Public's Trust**
- **Enhance the Charitable Mission**
- **Provide Continued Basis for Tax Exemption**
- **Grow the Business**

Non-Profit Governance

Building an Effective Board

- **Compatibility**
- **Clear Expectations**
- **Commitment**
- **Communication**
- **Competence**



Non-Profit Governance

The Mission

- **Set, Approve, Review the Vision and Strategic Direction**
- **Select and evaluate the performance of Executive Director**
- **Partner with management to pursue the goals and commitments**
- **Review and approve the annual budget, major transactions**
- **Take responsibility for compensation**
- **Adopt and enforce appropriate policies and procedures**

Non-Profit Governance

Meetings

- **Review finances and activities**
- **Quorum, notification, committees**
- **Electing and removing Board members**
- **Term limits**
- **Celebrate your accomplishments!**

Non-Profit Governance

Training

- **Orientation for new members**
- **Awareness of personal responsibility and liability**
- **Legal protections, insurance**
- **Self-assessment**
 - **Review duties and guidelines for each member**
 - **Attendance, preparation, participation**
 - **Expertise**

Non-Profit Governance

Fundraising

- **State registration**
- **Accurate solicitations**
- **Contemporaneous receipts**
- **Donor intent**

Non-Profit Governance

Diversity

- **In Appearance**
Respect for the culture and community being served
- **In Thought**
Background, viewpoint, perspective
- **In Talent**
Finance, accounting, investments, legal, fundraising, marketing, advocacy

Non-Profit Governance

Independence

- **Compensation**
 - Employee
 - Officer
 - Related Organization
- **Independent Contractor**
 - \$10,000 or less
 - Reimbursed expenses
 - Reasonable Compensation for Board service
- **Transactions with Interested Persons**
 - Excess benefit
 - Loans To or From
 - Grants of Assistance
 - Business Transactions

Non-Profit Governance

Compensation

- **Rebuttable Presumption of Reasonableness**
 - **Set by independent members of the Board**
 - **Use of comparability data**
 - **Adequate documentation**

Non-Profit Governance

Policies

- **Conflict of Interest**
- **Whistleblower**
- **Document Retention/Destruction**
- **Disclosure of Governing Docs, Financial Statements, etc.**
- **Reimbursement**
- **Travel, spousal travel**
- **Gift acceptance**
- **Investments**
- **Code of Ethics**
- **Employee Handbook**



FIN 48 for Nonprofits



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 #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**

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

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.**



Nonprofit Organizations

Jeffrey Schragg, Exempt Organizations Practice Leader
jschragg@argy.com
703.770.6313

Leslie Pine, Audit Partner
lpine@argy.com
703.770.6334

David Trimner, Tax Partner
dtrimner@argy.com
703.770.4450

Maili Montgomery, Audit Principal
mmontgomery@argy.com
703.770.6322

Lori Collingsworth, Tax Senior Manager
lcollingsworth@argy.com
703.770.6393

These materials have been created by and belong solely to Argy, Wiltse & Robinson, P.C. Tax advice contained herein is not intended or written to be used and cannot be used for the purpose of avoiding tax-related penalties that may be imposed on the taxpayer. Argy, Wiltse & Robinson, P.C. is not rendering legal advice and assumes no liability whatsoever in connection with its use.