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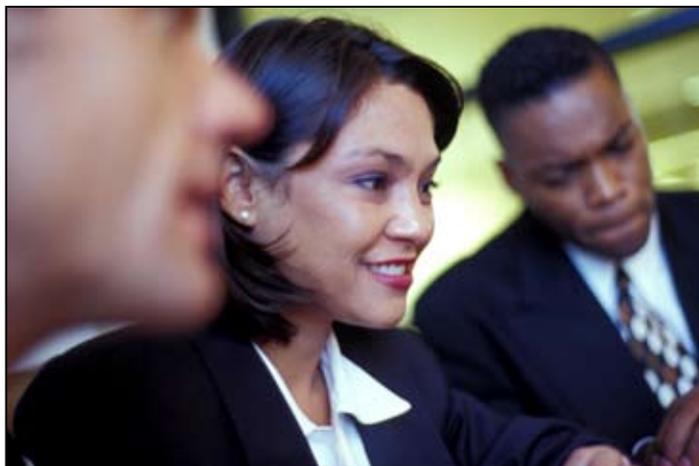
NonProfit

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A NEWSLETTER FOR NONPROFIT DECISION MAKERS

SUMMER 2008

Compliance Update Maintaining Your Tax-Exempt Status



corporate records book should also contain a copy of your articles of incorporation, bylaws, application for tax-exempt status (Form 1023), and tax exemption determination letters from the IRS and your state tax agency.

Political activities. While 501(c)(3) organizations are legally entitled to lobby and advocate for the causes and

constituents they represent, they are prohibited from participating in partisan politics – working directly for a political party or candidate, for example. In addition to revoking nonprofit status, the IRS can assess a special excise tax against the organization and its managers, which includes board members.

However, for tax-exempt nonprofits that want to participate in lobbying, the IRS simply sets a limit on the money they can spend on political activities. The general rule is that “no substantial part” of an exempt organization’s activities may be directed toward influencing legislation. Caution is warranted here, as the substantiality rule can be interpreted quite widely.

Inurement. The area that poses the greatest risk of inadvertent noncompliance is what the IRS calls “private inurement.” Here, regulations prohibit any part of the organization’s net earnings (or operations) from accruing to the benefit of private shareholders or individuals. Quite simply, a nonprofit

A nonprofit’s status as a tax-exempt organization is a crucial one, and the financial implications of losing it are substantial.

An organization losing its exempt status would become subject to federal income tax, and state and local tax exemptions (especially for property tax) would no longer be available. In addition, donors would be unable to deduct contributions – making fundraising difficult, if not impossible.

What Triggers Trouble

A variety of things can jeopardize your organization’s tax-exempt status. But proactive organizations understand the incredible value of this status and guard it carefully. Here are a few things to watch:

Your records. Good corporate records help to not only protect your organization’s tax-exempt status, but also preserve directors’ limited personal liability. Good record keeping means preparing accurate minutes of meetings and documenting important corporate decisions. Your

Accounting for Non-Cash Contributions



Here's a telling fact: More than 90 percent of the wealth in this country lies in non-liquid assets.

With this in mind, nonprofits that are prepared to accept non-cash donations — everything from fine artwork and jewelry to real estate and intellectual property — are likely to prosper in the coming years.

The Reporting Challenge

Nonprofits that tap into this rich stream of non-cash assets will face an additional challenge: how to properly account for these contributions. This is especially critical in light of the IRS, Congress and the public demanding more complete and timely Form 990 disclosure from nonprofits. In fact, reporting requirements have increased substantially on the revised Form 990 that goes into effect for the 2008 tax year (for returns due May 15, 2009 or after).

Reporting — Nonprofits that receive more than \$5,000 in non-cash contributions are required to report the number of contributors, values, methods of valuation and the balance sheet value (if any) of the contributions on Form 990.

Valuing — The method of valuing non-cash contributions should be carefully selected. For example, it's safest to value gifts of "commodities," such as bulk contributions of food, clothing, medical equipment or supplies, at not more than wholesale value. Here, documenting the value through dealers or published price lists is a wise move.

Note that when providing a receipt for a non-cash contribution, nonprofits should not provide a value to the donor. Donors are responsible for establishing the value that they deduct as a charitable contribution.

Acknowledging — You may provide a letter describing the property received. You may also be asked to sign IRS Form 8283, Non-Cash Charitable Contributions (which the donor must attach to his or her return), to acknowledge receipt of a non-cash gift, but you are not attesting to the donor's valuation of the gift.

Reporting — Upon the sale of a used car or other vehicle, you'll need to report to the donor and the IRS the amount you receive, using Form 1098-C, Contributions of

Motor Vehicles, Boats, and Airplanes. Likewise, if you receive property for which the donor claims a deduction of at least \$5,000 and you then sell or otherwise dispose of it within three years, you must report the amount received for the property on Form 8282, Donee Information Return (Sale, Exchange, or Other Disposition of Donated Property). To report "qualified donee income" from donated intellectual property, you'll need to file Form 8899, Notification of Income from Donated Intellectual Property.

Plan Now

Accepting non-cash donations is not without its challenges. But the benefits can be great. A good first step is to develop a policy that describes the types of gifts your organization will accept. This allows your staff and board to work through the practical issues, such as costs associated with certain gifts. It also allows you to name the individuals responsible for gift acknowledgement, and set a standard for the time in which acknowledgement is to be completed. ■

For more information contact Dave Siehoff at 630-545-4503.

Sold! Accounting For Auctions

Auctions (both silent and live auctions) result in a number of reporting issues on Form 990. Record the value of contributed items as non-cash contributions, and report them at fair market value on Line 1.

If the auction item is the use of property (a week at a vacation resort, for example) or personal services (such as 10 hours of babysitting), nothing is reported as a contribution. Report the sales activity as a special event on Line 9.

If someone bid more than the fair market value for the item, the excess is a contribution that should go on Line 1 (and in the parentheses on Line 9a).

corporation cannot be organized to financially benefit its members, officers or directors. Technically, any inurement, regardless of amount, can trigger the loss of exempt status.

Compensation. Charitable organizations are certainly permitted to pay "reasonable" compensation for services provided by their chief executive officers, other executives and directors. But if executive compensation is too high relative to the job performed, an organization can find itself caught up in the web of "intermediate sanctions" — special punitive taxes created by Congress. An executive's compensation is not generally considered to be excessive if it is consistent with the compensation paid to executives with comparable jobs in comparable organizations. Further, the IRS generally presumes that the compensation is reasonable if each of the following conditions are met:

Disinterested person(s) made the compensation decision.
Appropriate data was used in making the compensation decision.
The decision was documented.

Unrelated activities. As long as a nonprofit's activities are associated with its purpose, any profit made from them is not taxable. Sometimes, though, a nonprofit organization will earn income through activities that aren't directly related to its nonprofit purpose. For example, the directors of an organization dedicated to preserving open space may collect a consulting fee for advising other nonprofits (obviously, an unrelated activity to the nonprofit's purpose to preserve green space).

The IRS requires nonprofits to pay corporate income taxes on such unrelated income over \$1,000, whether or not the group uses that money to fund its tax-exempt activities. If a nonprofit spends too much time on unrelated activities, or if the unrelated activities generate "substantial"

income, the group's nonprofit status may be jeopardized.

As an alternative, organizations that have successful unrelated businesses may choose to put them in a separate, for-profit corporation operated as a subsidiary. The for-profit subsidiary then operates the unrelated business, pays taxes on the net income and contributes all or some of the remaining net income to the charitable organization.

Your mission. To ensure adherence to your organization's mission, board members should regularly review the mission statement, organizing documents and programs. But what happens if your 501(c)(3) organization decides it wants to change its mission of providing medical education conferences and begin assisting children?

According to Karen Courney, partner, Wolf & Company LLP and a member of the *Not-for-Profit Group*, "In this case, you must make sure that your new activities are, in fact, a permitted purpose under your home state's nonprofit corporation statute and, if so, amend your articles of incorporation. You would also need to amend the registration(s) you have on file with state charitable solicitations officials as well as notify the Internal Revenue Service through a letter specifying the changes from your original application, Form 1023."

Note that the IRS may ask further questions or require you to file a new Form 1023 (application for recognition as an exempt organization).

Remember Your Roots

In this era of increased scrutiny, you'll need to take steps every day to protect your tax-exempt status. Start by reviewing the IRS' informative online training tools at www.stayexempt.org. ■

For more information call Karen Courney at 630-545-4511.

The Case Of Health Care

A notable example of how important it is to actively maintain your tax-exempt status is the current battle being waged over the legal status of not-for-profit hospitals and health systems. A recent front-page article in the Wall Street Journal outlined charges from community advocates, state and municipal tax commissions, and state attorneys general that modern not-for-profit hospitals and health systems have violated their "explicit or implicit contract" with the federal government to serve uninsured patients in return for significant tax breaks.

A number of hospitals and health systems have also received letters over the past year from the IRS requesting documentation on executive compensation and benefits, deferred compensation plans and executive contracts. In some circumstances, these soft audits have led to full-blown IRS audits and scrutiny of the entire not-for-profit operation. In addition, there appears to be increased interest by the IRS in joint ventures between not-for-profit hospitals and for-profit or private individuals, including physicians.

Common themes running through these health care cases include:

- Profits are substantial, but only a small percentage was spent on charity care.
- Grants and contributions were a low percentage of gross revenue.
- The majority of revenue was generated by patient billings.
- Extensive screening was required to qualify for financial assistance programs.
- The availability of charity care and financial assistance was not communicated.



*A Member of the
Wolf Financial Group*



Nonprofit Notes

Does Your Board Know Its Legal Duties?

There are three fundamental legal duties that all board members must follow. These are commonly known as fiduciary duties and apply to everything that the board of directors does. If board members fail to follow them, they could be held liable for any negative consequences of their actions:

1. Duty of Care – Legally, this is defined as “the amount of care that an ordinarily prudent person would exercise in a like position and under similar circumstances.” In practical application, this means that board members must exercise reasonable care when they make decisions for the organization.

2. Duty of Loyalty – This requires that board members keep the best interests of the organization in mind at all times when making decisions (i.e., avoiding conflicts of interest).

3. Duty of Obedience – This requires board members’ actions be consistent with the organization’s mission statement, articles of incorporation, bylaws and tax-exemption documentation. In other words, the nonprofit’s central goals must guide all board decisions. In addition, board members must comply with all applicable laws and regulations.

It is critical to provide thorough orientation training shortly after members are elected. Have existing board members attend, too, for a refresher. Then provide ongoing training as needed. Cover federal and state laws as they relate to the duties of board members, as well as laws and regulations affecting the organization (tax-exemption, fundraising, employment, etc.). ■