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# 2013 Form 990 Update GASB/990 Update Seminar Phoenix, AZ May 20, 2014

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# Learning Objectives

- Understand current IRS initiatives and focus areas.
- Gain awareness of the IRS Tax-exempt Division.
- Be able to identify and address some of the key changes in the 2013 Form 990.
- Understand challenges and opportunities within the Form 990.

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# IRS Tax-Exempt Division

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# Federal Events in 2013 – Turmoil at the IRS

- A “BOLO” list for politically affiliated organizations came to light in early May 2013.
- Congressional investigation is ongoing, although for practical purposes it seems to be over unless new information surfaces.

# Federal Events in 2013 – Turmoil at the IRS

- During 2013, the IRS Commissioner, TE/GE Commissioner, and EO Division Director were replaced.
- Practical impact:
  - Exemption applications have been experiencing greater delays. We have seen the backlog starting to decrease over the last several months.
  - Other IRS activities were slowed or stopped.
  - IRS is being extremely cautious

# Federal Events in 2013 – Turmoil at the IRS

- The IRS is considering moving the EO division to Cincinnati.
- Wonder why – Perhaps to remove it from the Washington DC spotlight?

# Regulatory Climate

- Exempt organization sector continues to be highly scrutinized
  - IRS oversight
  - State and local compliance
  - Legislative
  - Donors
  - Constituents
  - Media



# Regulatory Climate

- Federal - State Coordination Continues
  - Sharing of information between federal and State regulators
  - Increase in the number of referrals
  - Common issues
    - ◇ Private benefit and inurement
    - ◇ Nonfilers
    - ◇ Political activities of 501(c)(3) organizations
    - ◇ Employment tax issues
    - ◇ Organizations not operated as required by their exempt status
  - Current status: Ongoing coordination continues

# EO Regulatory Overview

- Governance Study – Preliminary data released in 2013
  - Study of various governance practices of 1,300 public charities selected for audit
  - Preliminary results released
  - Resulting in a statistical sampling of 501(c)(3) and (c)(4) organizations
  - Significant diversion of assets may trigger additional inquiries
  - Current status: Governance continues to be a focus upon examination

# 2013 IRS Work Plan – UPDATE

- Released in 2012 – A new 2014 IRS work plan has not been issued by the IRS EO division
- International Activities
  - Examination of organizations reporting a foreign bank account on the Form 990
    - ◇ Failure to file FBAR
    - ◇ Inadequate recordkeeping
    - ◇ Lack of discretion & control over funds sent abroad
    - ◇ Failure to file employment tax returns (or incorrect returns)
  - Current Status: Continues to be a focus of the EO division

# 2013 IRS Work Plan – Update

- Group Ruling Questionnaire Issued
  - IRS ACT Report recommendation and large number of subordinates whose exemption was automatically revoked
  - Questionnaire issued to approximately 2,000 central organizations
  - Gathering information on relationship between central organizations and subordinates, practices, compliance, etc.
  - Current status: Unknown

# 2013 IRS Work Plan – Update

- Self Declarers Questionnaire
  - Compliance questionnaire issued to 501(c)(4), (5), and (6) organizations
  - Focus on whether organizations are classified correctly and compliance with applicable tax laws
  - Current status: Unknown

# 2013 IRS Work Plan – Update

- Form 990 Information in Compliance Efforts
  - Charitable spending initiative
  - Compensation transparency
  - Political activity
  - Unrelated business income and Form 990-T
  - Current status: Unknown
  
- Interactive Form 1023
  - Current status: Released 09/30/2013

# 2013 IRS Work Plan – Update

- The IRS released a draft Form 1023-EZ in April of 2014.
  - It was created for smaller organizations to use to apply for exemption under Code Sec. 501(c)(3)
    - ◇ Receipts no more than \$200,000 and total assets no more than \$500,000.
  - It is a streamlined 2-page form (actually 3 pages).
- College & University Report
  - Current status: Issued

# Colleges and University Study

- In April 2013, the IRS concluded a 5-year study of tax compliance by 501(c)(3) colleges and universities.
- Sent questionnaires to 400 randomly selected schools.
- Selected 34 responders for audits.
  - Not random.
  - “[T]heir questionnaire responses and Form 990 reporting indicated potential noncompliance in the areas of unrelated business income and executive compensation.”



# Colleges and University Study

- UBIT Results:
  - Increased UBIT of 90% of audited schools by \$90 million.
  - Made over 180 changes to UBIT amounts on 990-T's.
  - Disallowed over \$170 million in NOL carryforwards.
- UBIT Causes:
  - Expenses not sufficiently connected to UBIT revenues.
    - ◇ Either it wasn't or the organization couldn't prove it was.
  - Improper expense allocations.
  - Math errors.
  - Lack of profit motive (consistent losses).
  - Classifying exempt activities as unrelated.

# Colleges and University Study

- Reasonable Compensation Results:
  - 20% failed to meet the rebuttable presumption.
- Reasonable Compensation Causes:
  - Using inappropriate comparability data.
  - Compared organizations were “not similarly situated”.
  - Compensation studies didn’t document why certain organizations were included.
  - Compensation studies didn’t explain why the selected organizations were comparable.
  - Compensation surveys didn’t indicate whether dollar amounts included salary only or all compensation.

# Colleges and University Study

- Employment Tax Results:
  - About 12 schools were audited.
  - Adjusted wages at 100% of audited schools by \$36 million.
  - Taxes and penalties totaled over \$7 million.
- Employment Tax Causes:
  - Failure to tax personal use of automobiles, housing, social club memberships and/or travel.
  - Misclassification of employees as independent contractors.
  - Failure to withhold taxes for non-resident aliens.

# Colleges and University Study

- Deferred Compensation Results:
  - About 8 schools were audited.
  - Adjusted wages at 50% of audited schools by \$1 million
  - Taxes and penalties totaled over \$200,000.
- Deferred Compensation Causes:
  - Payments were not conditioned upon future performance of substantial services (no substantial risk of forfeiture).
  - Loans from 403(b) plans exceeded limits.
  - Deferrals for 403(b) plans exceeded limits.
  - Additions to 403(b) plans exceeded limits.

# Colleges and University Study

- Practical impact:

“The examination of college and universities identified some significant issues with respect to both UBI and compensation that may well be present elsewhere across the tax-exempt sector. As a result, the IRS plans to look at UBI reporting more broadly,... and to ensure... that tax-exempt organizations are aware of the importance of using appropriate comparability data when setting compensation.”

- Regularly monitor for UBI activities
- Appropriately capture UBI expenses
- Appropriately report activities to the IRS
- Use appropriate comparability data in setting compensation
- Appropriately classify workers as employees vs. independent contractors
- Appropriately classify benefits and deferred compensation

# 2013 Form 990 Changes

- The IRS clarified that a short period return cannot be e-filed unless it is an initial first-year return or if it is the final return due to termination. The initial return or terminated return box must be checked.
- Clarified for organizations changing their accounting method (states accounting period early in the instructions) must report their §481(a) adjustments in Parts VIII through IX of Form 990 and on Sch D, Parts XI and XII. (Note – Form 3115 is required when a tax accounting method is changed).

# 2013 Form 990 Changes – Heading Items A-M

- Clarifies the documents to attach to the 990 when there is a name change.
- Clarifies what must be attached to the 990 when the organization has terminated, dissolved, gone through a merger, or had its exemption revoked by the IRS.

# Form 990 Changes – Part IV Schedule Checklist

- Clarification of when an organization can exclude on Schedule B contributors that fall below the \$5,000/2% threshold.
  - In order to qualify to use this rule, you must qualify as a 509(a)(1)/170(b)(1)(A)(vi) organization using Part II of Schedule A and meet one of the following tests:
    - ◇ Not yet in existence for 5 years.
    - ◇ Meet the 33 1/3% test in the current year.
    - ◇ Meet the 33 1/3% test in the immediate preceding year.



# Form 990 Changes – Part IV Schedule Checklist

- Clarification of when an organization has to answer “Yes” to report that it became aware of an excess benefit transaction with a disqualified person in a prior year.
- Clarification that if an organization reports amounts on Part X, lines 5, 6 or 22 for receivables from or payables to interested persons must file Schedule L, Part II.

# Form 990 Changes – Part VI Governance Section

- Clarification as to the compensation that must be reported on Schedule O when a management company makes payments to an interested person.

# Form 990 Changes – Part VII Officer etc. and Independent Contractor reporting

- Clarifies that directors' compensation for non-director services to the organization and related organizations must be reported in Part VII, Section A.
- Clarifies that compensation paid by a management company to one of the organization's officers, directors, trustees, key employees or highest compensated employees is generally not reportable in Part VII, Section A (reportable instead on Schedule O per the previous slide).

# Form 990 Changes – Part VIII Statement of Revenues

- Line 1 instruction clarifies that discounts on services cannot be reported as contributions. This is in accordance with the requirement that donated services and use of facilities be excluded on the 990.
- Line 10b instruction clarifies how to value and report the cost of donated goods on line 10b (cost of goods sold line).

# Form 990 Changes – Part IX, Statement of Functional Expenses

- The line 11 instructions clarify how to report expense payments and reimbursements to contractors. If the expense payments/reimbursements can be identified and distinguished from the services portion of the payment, then the expense portion is to be allocated to the appropriate expense category on the 990.

# Form 990 Changes – Glossary

- Adds clarification that an organization does not include donations of services or discounts provided on sales of goods as a contribution.
- Includes a new definition for a “domestic individual”. Are you curious? Well, it is an individual who lives or resides in the United States and is not a foreign individual.

# Form 990 Changes – Appendix D, Public Inspection of Returns

- This section now clarifies that both the original and any amended returns filed are subject to disclosure under these rules.

# Form 990 Changes – Appendix E, Group Returns

- Clarifies how to determine if a subordinate meets the threshold for reporting a diversion of assets in Part VI, line 5.
- Clarifies when Schedule L, Part IV (transactions with interested persons) reporting is required for business transactions of subordinates and their interested persons.



# Form 990 Changes – Appendix F, Disregarded Entities and Joint Ventures

- Now contains a clarification of when a single-member LLC should be treated as a disregarded entity of its sole member/owner.

# Form 990 Reporting Challenges – Part VII Officer, Director, etc. Compensation.

- Compensation must be reported on the calendar year regardless of the organization's tax year. If on a fiscal year, report for the calendar year the ends during or within your fiscal year.
- Column D compensation must agree to the larger of box 1 or 5 of the person's Form W-2 issued by the organization for that calendar year.

# Form 990 Reporting Challenges – Part VII Officer, Director, etc. Compensation.

- Column E compensation must agree to the larger of box 1 or 5 of the person's Form W-2 issued by a related organization (generally one reported in Schedule R).
- Column F includes calendar year retirement plan payments made by the organization on the behalf of the person plus any calendar year non-taxable benefits, such as health insurance, that were paid by the organization on behalf of the person.

# Form 990 Reporting Challenges – Part VII

## Officer, Director, etc. Compensation

- If Schedule J reporting is required:
  - W-2 compensation has to be broken down between base compensation, bonus plus incentive compensation, and any other compensation reported in box 1 or 5 of the Form W-2.
  - Retirement plan contributions have to be reported separately from other nontaxable benefits.
  - Nontaxable benefits include health, life, dental, employee deferrals to cafeteria plans plus dependant care.

# Form 990 Reporting Challenges – Schedule K.

- If the organization has reportable tax-exempt bond financing, Schedule K is a challenge to complete.
- There are additional questions on bond compliance.
- We recommend that you have your bond counsel review the Schedule K prior to filing.

# Questions & Answers





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