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Profitable Solutions for Nonprofits

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Nonprofits get a bag of new rules from tax overhaul

When President Trump signed the massive federal income tax overhaul into law on December 22, 2017, much was made of nonprofits' understandable concern that the higher standard deduction would reduce incentives for charitable giving. The concern is, of course, extremely important, but the new law also includes several other provisions that could affect nonprofits.

Calculating unrelated business taxable income

The Tax Cuts and Jobs Act (TCJA) has substantially lowered the corporate tax rate to 21%, a significant benefit to any nonprofits already paying unrelated business income tax, which is imposed at the corporate rate. But when it comes to calculating the income that is subject to this tax, the new law brings some bad news for nonprofits.

The TCJA requires nonprofits to compute unrelated business taxable income (UBTI) separately for each unrelated business activity and pay tax on any activity with net income. That means nonprofits can't use a loss from one unrelated business to offset income from a different unrelated business for the same tax year.

They could, however, use one year's losses on an unrelated business to offset profits in a different year for that business, subject to certain restrictions. For example, if your nonprofit incurred a loss in its bookstore business in 2018, it could use that loss to offset bookstore profits in 2019.

The TCJA also makes certain fringe benefits includable in UBTI. These include qualified transportation benefits (for example, transit passes), qualified parking benefits and access to any on-site athletic facility.

Compensating executives

The TCJA also imposes a 21% excise tax on "excessive" executive compensation. The tax applies to the sum of any compensation (including most benefits) *in excess of $1 million* paid in the tax year to a covered employee *plus* certain large payments to that employee upon his or her departure from the organization (known as "excess parachute payments").

A "covered employee" means a current or former employee reported as one of your five highest paid employees for any taxable year beginning after 2016. Licensed medical professionals aren't covered employees for this tax.

But what's an "excess parachute payment"? A payment generally is considered an excess parachute payment if:

1. It's contingent on the employee's departure, and

2. The present value of these payments equals or exceeds three times the base amount, which is the employee's average annual compensation for the preceding five years.

The excess parachute payment subject to the excise tax is the amount of the parachute payment less the base amount.

The increase in the standard deduction is expected to reduce the number of taxpayers who itemize and, thus, can deduct charitable contributions.

Discouraging donations?

The increase in the standard deduction — it's expected to reduce the number of taxpayers who itemize and, thus, can deduct charitable contributions — isn't the only change that could affect giving.

For example, the TCJA doubles the estate tax exemption to $10 million (indexed for inflation) through 2025. With fewer wealthy individuals at risk of paying this tax, fewer people may make the generous donations that have been partly motivated by a desire to shrink their taxable estates. Plus, the TCJA eliminates any deduction for donations made in exchange for the right to buy season tickets to college athletic events.

The TCJA does raise the limit on cash donation deductions from 50% of adjusted gross income to 60%. But cash donations at this level are uncommon, so the higher limit may not stimulate much additional giving.

Obtaining financing

Some nonprofits issue tax-exempt bonds to finance construction and other capital activities. These bonds typically pay lower interest rates than other bonds. But investors are willing to accept the lower rates because they aren't required to pay income taxes on the interest.

The TCJA, however, repeals the tax-exempt treatment for interest paid on a bond issued to refinance another tax-exempt bond. An "advance refunding bond" is used to pay principal, interest or redemption price on a prior bond issued more than 90 days before redemption of the refinanced (refunded) bond.

Let's say you issue tax-exempt bonds at 4% interest but later discover you can refinance the bonds at 3% interest. Under the TCJA, the interest payments on the 3% advance refunding bonds won't be tax-exempt for investors — that means you'll need to pay more interest as recompense for the investors' increased tax liability.

Charting the course ahead

Despite the advantage of a lower tax rate on unrelated business income, the new income tax law may reduce overall charitable giving while simultaneously increasing some nonprofits' costs. Your CPA can help your not-for-profit chart the best course forward. ■

Oops, we did it again!

Avoid these 4 common finance-function mistakes

Most nonprofits are understandably laser-focused on their mission, and other, seemingly less-critical matters may fall between the cracks. But if the finance function doesn't receive the attention it deserves, you run the risk of IRS penalties, reputational damage and lost revenue.

Here are four common mistakes related to managing the finance function:

1. Failure to report unrelated business income

According to the IRS, unreported business income ranks as one of the most common tax filing errors made by nonprofits. Revenue generated from a trade or business that your organization regularly engages in, but that isn't substantially related to furthering its tax-exempt purpose (other than the need for funding), may well be subject to the unrelated business income tax.

Generally, an exempt organization with $1,000 or more of gross income from an unrelated business activity must file Form 990-T. And the nonprofit must pay estimated tax if it expects its tax for the year to be $500 or more.

2. Misclassification of employees

Nonprofits have long turned to independent contractors in the face of tight budgets and small staffs. Contractors can provide valuable flexibility, reduce administrative work and cut your costs and potential liability.

The IRS, however, has strict tests for determining whether an individual is indeed an independent contractor or is actually an employee for whom you must withhold, and pay, payroll taxes. If the IRS reclassifies any of your contractors as employees, you'll likely find yourself on the hook for back payroll taxes, interest and penalties. You also might be subject to minimum wage and overtime laws, Social Security and Medicare contributions, and unemployment and workers' compensation premiums.

3. Overreliance on software

Nonprofits sport plenty of choices when it comes to off-the-shelf accounting software packages. Although these products can improve efficiency, you can rely on them too much. The fact is that accounting software isn't fail-safe. And it may not flag a mistake or spot possible fraud.

Even with the most expensive and sophisticated software, garbage in means garbage out — the output, in other words, is only as reliable as the input. For example, if an employee enters cash receipts for the wrong amounts or dates, or simply fails to enter them at all, that could have a domino effect. Everything from financial statements to tax filings potentially would be impacted. You need a knowledgeable individual (someone other than the person who makes the entries) to review journal entries, reconcile account balances and perform other checks and balances.

4. Failure to invest in expertise

An overreliance on software also may lead to inadequate investment in accounting resources. Some organizations may count on volunteers to serve as their accountants. Think about the critical role your financial reporting plays in obtaining funding, though. Can you really afford to leave it to underinformed volunteers or one-size-fits-all software?

Yet some nonprofits continue to direct a smaller percentage of their budgets to finance and accounting than for-profit companies do. They may reason that professional accounting expertise will cost too much. But the costs of not retaining such help could put a bigger dent in your wallet in the long run.

The bottom line

Mistakes in the oversight of the finance function can get in the way of accomplishing your organization's mission. By allocating sufficient resources to this area, you can fortify your financial footing, protect your reputation and arm your leadership with vital information for decision-making. ■

Shared space

What to consider before teaming up

Nonprofits nationwide are increasingly considering shared workspace arrangements to lower rising facility costs. These arrangements are particularly appealing in areas where nonprofits are being priced out of the real estate market and to those determined to cut operating costs.

Options to choose from

The term "shared space" refers to workspaces shared by small businesses, freelancers, consultants, start-ups and others. Depending on their needs, tenants can pay for short- or long-term access to private offices, conference rooms and common areas. Office equipment and services, such as high-speed Internet; photocopiers, printers and scanners; and coffee and office supplies, are shared among the tenants.

The shared space trend in recent years has led to the development of several options. For example, you could rent space in a dedicated shared workspace facility that also might provide "back-office" services such as HR. Many of these arrangements welcome a variety of businesses, but some cater primarily to nonprofits. For example, a facility in Austin, Texas, specifically targets nonprofits, social entrepreneurs, philanthropic organizations and the businesses that support them.

Similarly, some private foundations, with more space than they require, lease out the excess to nonprofits. As tax-exempt organizations, they avoid steep property taxes and pass the savings along to their tenants in the form of reduced rent.

Or your nonprofit could join forces with another charity — perhaps one that serves the same population. The two organizations would rent a shared facility and slice the cost in half. You might also rent out unused space to other organizations, generating revenue to offset your rent obligations. Another option: You might be able to find a for-profit business willing to donate space.

Potential perks

The most obvious benefit of sharing space lies in the cost savings compared with renting or buying your

Beyond the budget: More than splitting expenses

Space sharing can net advantages in addition to the financial savings, including an environment that cultivates collaboration. At best, you might end up working together on projects with organizations that have similar missions, extending your reach and impact. But bouncing ideas off of people from different disciplines and industries also can pay off.

In addition to casual workday interactions, facilities that accommodate a range of businesses often offer networking opportunities and events such as happy hours, yoga classes, service projects and community lunches. Facilities that mainly or solely host nonprofits might provide workshops on topics relevant to tenants' needs, such as proposal writing, advocacy and volunteerism.

own space. Why, for example, pay annual rent on space that includes a conference room you only use for semiannual board meetings? And organizations of all sizes benefit by efficient use of supplies and equipment, utilities and maintenance expenses.

Flexibility is especially valuable for nonprofits in the early stages of development. Young organizations usually don't want to commit to long-term leases before they've a handle on how much space they'll need in the future. Sharing space is a more appealing option than operating out of a founder's home.

Additional cost sharing opportunities

Workspace isn't the only thing you can share with other organizations to reap impressive savings. You also can cut your costs by:

Sharing staff. Your organization may, for instance, be too small to justify a full-time IT person — you might not have the need or the budget. But perhaps you and another organization together have sufficient need and funding for such support.

Sharing equipment. You probably have equipment that goes unused or is used below capacity. Think about sharing it with another organization whose needs for such equipment complement yours. (For example, a summer music program could share instruments with a program that operates during the school year.)

Sharing buying power. Consolidate your buying power with that of other nonprofits to obtain lower rates, discounts and possibly even improved service.

Not all rainbows and candy

Shared space isn't all rainbows and candy, though. Organizations need to take a variety of factors into consideration before taking the plunge. Some nonprofits, for example, might not want to share space with "competing" organizations that serve the same population or go after the same funding sources.

You also should think about:

- Legal issues, including lease obligations, compliance requirements and potential liabilities,
- Culture considerations (Would your culture be able to thrive in a shared arrangement? Would it clash with other tenants' cultures?), and
- Adequacy of technology resources.

You can assess many of these issues by making site visits, both scheduled (to get the sales pitch) and unscheduled (to get a more realistic lay of the land).

Is it right for you?

As nonprofit budgets get tighter and come under more scrutiny, cutting your space-related costs may provide some peace of mind and pave the way to sustainability. Your CPA can help you determine whether moving your operations to shared space is a solid financial decision. ■

NEWSBITS

Many nonprofits are poised to grow, but recognize risks

More than three-quarters of nonprofits are at least "somewhat likely" to pursue growth through expanded fundraising efforts during the next 12 to 18 months, according to a recent study. *Nonprofit Finance Study: Managing Growth*, conducted by nonprofit software firm Abila, also found that 84% of the financial professional respondents expect to seek new grant funding opportunities. Nonprofits are at least "somewhat likely" to pursue partnerships with other organizations (72%), provide new services that will bring in new revenue (69%) and seek corporate sponsorships (67%).

The results don't only highlight a desire to grow among nonprofits. They also reflect the respondents' recognition that growth makes risk management more challenging. More than 60% indicated that, as their organization grows, their ability to manage risk becomes somewhat or much harder.

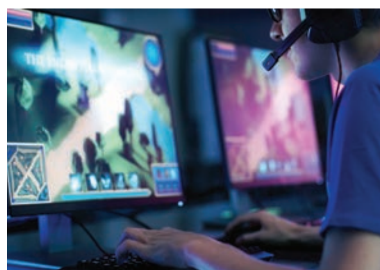
If your organization is poised for growth, the report suggests a number of risk management activities. Among them: creating contingency plans for future funding uncertainty, maintaining compliance with funding requirements, assessing internal controls and training employees. ■

Your 990-EZ filings get easier

One out of three nonprofits that file paper Forms 990-EZ make a mistake. That's according to the IRS, which is attempting to reduce errors with an updated form. The form has 29 "help" icons to help small and midsize nonprofits avoid common missteps.

The icons describe key information you need to complete many of the form's fields, and provide links to useful information on the IRS website. Once organizations complete their forms, they can print them for mailing to the IRS. Your CPA can work with you to ensure your 990 EZ is filed properly. ■

Gamers raise funds for hurricane victims



When natural disasters hit, many people look for ways to help the survivors get back on their feet. And some nonprofits have found particularly innovative approaches to compound the efforts they make and donations they receive. *The Los Angeles Times* reports, for example, that one charity, Direct Relief, received over $500,000 from thousands of online gamers in the wake of the 2017 hurricanes.

Gamers also raised more than $5 million for Save the Children over the last five years by holding marathon gaming sessions on live-stream platforms such as Twitch and Gaming for Good. The platforms let viewers watch and talk to their favorite players. The resulting donations — largely from young, male first-time donors — have prompted more nonprofits to reach out to the gaming community to build alliances. ■

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A Refresher on Public Charities and Private Foundations

If you are in the process of forming a charitable organization, then the decision to file as either a public charity or private foundation is a crucial one. Even as an existing 501(c)(3), if your corporate structure or source of funding changes, you may also need to reconsider classification.

While public charities and private foundations are distinctly different, together they make up the majority of active charitable organizations in the United States. Each type entity has different advantages and disadvantages, and each has different rules governing its operations. We hope the following review of the two will be useful, whether you are filing your initial application with the IRS or filling out your 990 for the current tax year.

Public Charities These organizations represent the majority of 501(c)(3)s in the US, even though applicants must prove in a series of tests why they should be public charities. With the exception of religious organizations and nonprofits whose gross receipts are less than $5,000, the IRS usually defines every charitable organization as a private foundation, unless the nonprofit specifically requests classification as a public charity.

Public charities usually carry out some form of direct, charitable activity. Additionally, however, they must be organized exclusively for 501(c)(3) activities. They must also have a diversified board of directors and meet other board-composition requirements. In terms of revenue, public charities must be supported by the general public, i.e., at least 33 percent of revenue must come from relatively small donors, other public charities, or the government.

Finally, depending on a public charity's total revenue, it has three tax filing options: the full Form 990, the Form 990-EZ, or the Form 990-N e-postcard.

Private Foundations Even though the private foundation designation can be a default position, it is most often a specific choice made by the applying organization. The primary reason is control. This control can be held by related parties (which is very limited for public charities) and funding can come from a small group of individuals and/or other organizations – even one family or individual. Greater control typically outweighs disadvantages such as deductibility limits on donors, mandatory Form 990-PF filings, and minimum annual asset distributions. In addition to stricter rules and regulations, these organizations also risk exposure to excise taxes and even loss of exempt status if they do not comply.

We hope this brief overview gives you a better or refreshed understanding of the differences between these classifications. If you are interested in learning in more detail about operational requirements of each type entity, LaPorte's nonprofit professionals welcome your inquiries. We have helped many of our clients through the process of setting up appropriate organizations or changing to a different type of organization if warranted.