Summer 2023

Profitable Solutions for Nonprofits

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How an energy-efficient building tax deduction could pay off for nonprofits

Much of the Inflation Reduction Act signed into law in late 2022 contains provisions intended to combat climate change, largely through tax incentives. Such tax breaks aren't usually relevant to the work of nonprofits. But if your organization is constructing new facilities or adding improvements, the Act's changes to one tax deduction could benefit your organization.

Tax break becomes permanent

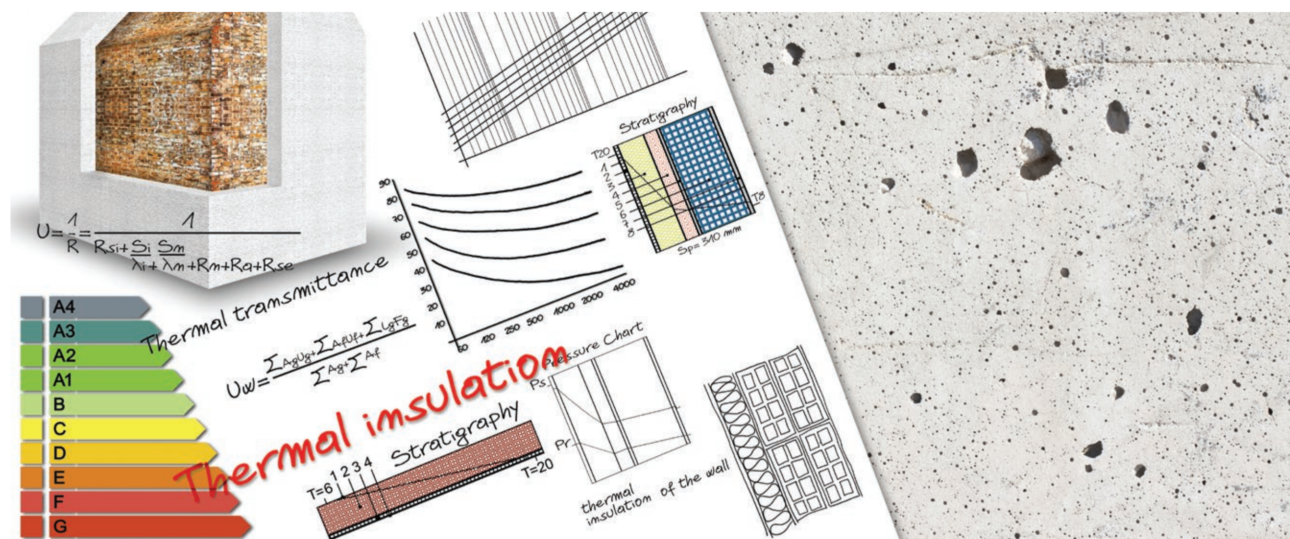
IRS Section 179D deduction for energy-efficient commercial buildings was made permanent by the Consolidated Appropriations Act of 2021. At that time, the deduction generally was available only to the owners of commercial properties and certain residential properties. Government entities with qualifying buildings could use the deduction by assigning it to qualified "designers."

A qualified designer creates technical specifications for the installation of energy-efficient commercial building property. Installation, repair or maintenance of such property isn't sufficient to qualify. Designers include architects, engineers, contractors, environmental consultants and energy services providers.

New rules

To qualify for the deduction before the Act, a taxpayer had to establish a 50% reduction in energy and power costs. The maximum deduction was $1.88 per square foot (adjusted for inflation). This meant it was worth as much as 63 cents per square foot for each of three eligible systems: HVAC and hot water, interior lighting, and building envelope. Taxpayers could claim the deduction once per property.

Under the Act and beginning in 2023, the qualification threshold drops to 25% energy savings. The base deduction amount is 50 cents per square foot, but a "bonus deduction" could substantially increase the deduction. To qualify for this bonus (up to $2.50 per



square foot), projects must satisfy prevailing wage and apprenticeship requirements. The deduction amount also increases as energy savings exceed 25% — up to $5 per square foot for projects that also meet the labor requirements. And the credit can be taken on a specific building every three years.

Benefit for nonprofits

How do these changes help nonprofits? The Act now permits all tax-exempt entities, not just governmental entities, to allocate their deductions to qualified designers. This could reduce your organization's costs on construction projects that incorporate sustainable materials. You may already have prioritized the use of such materials because it aligns with your mission and values or simply to cut future utility expenses.

Let's say you plan to build a 40,000-square-foot, LEED-certified building and to meet the labor requirements. You'll have $200,000 in tax deductions to allocate to qualified architects, engineers and other construction professionals. You can allocate the entire deduction to a single designer or make proportional allocations to multiple designers. That can help you negotiate a better overall price on the project than you would if you weren't able to allocate.

The exact deduction amount will be determined through a "Section 179D study" obtained by the designer. The study is performed by a qualified contractor or professional engineer. Among other things, this third party will have to make a site visit to your property to confirm that it has met or will meet energy savings requirements. You'll also need to sign an allocation letter that includes the following:

- The cost of the energy-efficient property (including labor),
- The date the property is placed in service,
- The amount of the Sec. 179D deduction allocated to the designer, and
- A declaration that the information presented in the letter is true and complete to the best of your knowledge and belief.

Note that you can't seek, accept or solicit payments from a designer in exchange for providing an allocation letter. Nor can you require a designer to pay you a portion of the deduction's value. Both of these practices would constitute an illegal kickback.

Cover your bases

Your preferred architect, engineer or other type of qualified designer may not have experience working on a project involving the allocation of the Sec. 179D deduction. We can help ensure you jump through all of the necessary hoops and negotiate deals that reflect the value of the deduction. ■

Do you qualify for cash refunds for tax credits?

In addition to expanding availability of the IRS Section 179D tax deduction (see main article), the Inflation Reduction Act makes another major change to energy-related tax incentives that could help nonprofits save money. It allows eligible organizations to receive certain tax credits — which otherwise would be of little use to nonprofits that pay no income tax — as direct payments from the IRS.

Nonprofits now may elect to receive a variety of credits as cash payments, including the following:

- Investment Tax Credit,
- Production Tax Credit,
- Credit for Qualified Commercial Clean Vehicles,
- Advanced Manufacturing Production Credit,
- Alternative Fuel Refueling Property Credit,
- Credit for Carbon Oxide Sequestration,
- Zero-Emission Nuclear Power Production Credit,
- Credit for Production of Clean Hydrogen,
- Clean Fuel Production Credit, and
- Advanced Energy Project Credit.

The IRS will make the credit payments after an eligible nonprofit files its return for the applicable year.

Be prepared for IRS audits of COVID-19 ERC claims

The availability of Employee Retention Credits (ERCs) during the height of the COVID-19 pandemic — particularly the ability to claim advance payments of the credits — played a critical role in keeping many nonprofits afloat. Now, however, the IRS has begun to subject some employers that claimed ERCs to audits. Given the extended five-year statute of limitations for such audits, nonprofits that claimed the credits need to prepare.

ERC in a nutshell

The ERC is a refundable tax credit intended for businesses, including nonprofits, that 1) continued paying employees while they were shut down due to the pandemic, or 2) suffered significant declines in gross receipts from March 13, 2020, to September 30, 2021. The 2021 credit generally is worth up to $7,000 per qualifying employee per quarter and up to $5,000 per qualifying employee per year in 2020, and its refundable nature makes it valuable for nonprofits (which normally don't have significant tax liabilities).

Specifically, an eligible employer must have:

1. Sustained a full or partial suspension of operations because of orders from a governmental authority that limited commerce, travel or group meetings due to COVID-19 during 2020 or the first three quarters of 2021,
2. Experienced a significant decline in gross receipts during 2020 or a decline in gross receipts in the first three quarters of 2021, or
3. Qualified as a recovery start-up business — which could claim the ERC for up to $50,000 total per quarter, without showing suspended operations or reduced receipts — for the third or fourth quarters of 2021 (qualified recovery start-ups are those that began operating after February 15, 2020, and have annual gross receipts for the three previous tax years of less than or equal to $1 million).

Importantly, for any quarter, the ERC couldn't be claimed on wages that were reported as payroll costs in obtaining Paycheck Protection Program (PPP) loan forgiveness or that were used to claim certain other tax credits.

IRS scrutiny

It's worth noting that being selected for an audit doesn't mean your organization did anything wrong. But if you did claim the ERC improperly, you'll likely be required to repay the credit, as well as penalties and interest.

And the ERC did come with several potential tripwires for employers. For example, the IRS may look closely at your eligibility for the credit (including your calculation of your average number of full-time employees in 2019 and subsequent quarters), determination of gross receipts, calculation of the credit amount, and application of the complicated aggregation rules.

Now is the time to review your analyses and ensure you have all assumptions and related supporting information documented. You're required to maintain adequate documentation for at least four years after the related employment taxes became due or were paid, whichever was later. Documentation may include:

- Payroll journals,
- Health plan expenses,
- Tax forms,
- Employee rosters,
- Copies of governmental suspension orders,
- Records showing declines in gross receipts for each relevant quarter,
- Documents related to PPP loan forgiveness and allocation of wages between your ERC and PPP wages, and
- Federal employment tax returns.

Don't wait to receive an examination notice from the IRS. Make sure you have the proper documentation now.

Final word of caution

If you relied on outside advisers when claiming the ERC, don't assume you're on solid ground. The IRS has warned employers to be wary of advisors that charged large upfront fees or fees based on the amount of the refund, or that encouraged ineligible organizations to claim the ERC. The alert highlights the importance of working with experienced and reputable tax experts. ■

What's the magic number?

Some guidelines for determining your board's size

Recruiting and retaining committed board members is a never-ending process. For many nonprofits, determining an appropriate-sized board takes time. Although state law typically sets the minimum number of directors a nonprofit must have on its board, it's up to each organization to determine how many board members it needs. Once your board size meets its state requirement, what should you consider? Both small and large boards come with perks and drawbacks.

Small boards

Smaller boards allow for easier communication and greater cohesiveness among the members. Scheduling is less complicated, and meetings tend to be shorter and more focused. Plus, the members' higher level of involvement can heighten their satisfaction.

Several studies have indicated that group decision-making is most effective when the group size is five to eight people. But boards on the small side of this range may lack the experience or diversity necessary to facilitate healthy deliberation and debate. And members may feel overworked. This can lead to burnout and an early departure.

Large boards

Burnout is less likely with a large board where each member shoulders a smaller burden, including when it comes to fundraising. A large board may include more perspectives and a broader base of professional expertise — for example, financial advisors, community leaders and former clients. Large boards typically foster strong institutional memories and provide more extended outside networks.

On the other hand, larger boards can lead to disengagement because members may not feel they have enough responsibilities or sufficient voice in discussions and decisions. Larger boards also require more staff support and can strain the CEO or executive director, who must develop a relationship with each member.

Making choices

If you're thinking about resizing your board, think about:

- The current sentiment about its size (is the consensus that it's too large or too small?),
- Board member responsibilities and desirable expertise,
- Fundraising needs,
- Committee structure,
- Your nonprofit's life stage (for example, start-up or mature),
- The size of your organization's staff, and
- The complexity of the issues facing the board.

You may have heard that it's wise to have an uneven number of board members to avoid 50/50 votes. In such a case, though, the chair can break a tie. Moreover, an issue that produces a 50/50 split usually deserves more discussion to come closer to consensus.

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Downsizing carefully

If you decide a larger board is in order, you likely already know how to recruit more members. Trimming the board is a trickier situation. For starters, you might need to change your bylaws. Generally, it's best to set a *range* for board size in the bylaws, rather than a precise number. Your bylaws already might call for staggered terms, which makes paring down simpler; as members' terms end, just don't replace them.

If part of the motivation for reduced board size is a lack of engagement, you could establish an automatic removal process. For example, members may be removed for missing a specified number of meetings. But remind exiting board members that the board isn't the only way they can serve the organization as there likely are many volunteer opportunities, including committee responsibilities, within the organization.

Finding the sweet spot

There's no board member size "sweet spot" that will work for every organization. In fact, it may take several attempts to find the right size for your organization. Consult your legal and tax professionals for help in making changes to your board's size. ■

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Nonprofit employment returns to pre-COVID-19 levels

Three years after the COVID-19 pandemic hit the United States, nonprofits appear to be in a significantly better place in terms of overall employment than they were at the end of 2021. That's according to the Nonprofit Employment Data Project at George Mason University.

It reports that the industry lost about 1.64 million jobs as of May 2020 and was still down by nearly 500,000 workers in December 2021. But the sector recovered the job losses by October 2022 and may have added new jobs in the final months of last year. The nonprofit workforce as of December 2022 was estimated to include about 107,000 more jobs than in 2017 — an increase of 0.86%. The researchers caution, though, that their estimates are based on the assumption that nonprofits kept pace with the overall private economy, and that's far from a certainty. ■

How to stop fundraisers from heading for the door

Forty-six percent of professional fundraisers plan to leave their current employers within two years — and 9% plan to leave the field altogether within that same time period. These numbers were shared in the new report "What Makes Fundraisers Tick," based on research conducted for Revolutionise International and the Institute for Sustainable Philanthropy.

The report digs into fundraisers' motivations, with an eye toward boosting retention. Among the most common motivations are well-being, competence, autonomy and connection, as well as the ability to make a difference for a cause they're passionate about. For example, being treated with respect as professionals and receiving support from leaders and boards rank high as motivators. Lack of professional growth, autonomy and board support are cited as "draining," or de-motivating, factors. Notably, salary and benefits don't figure prominently in either list of factors. ■

Tech nonprofit releases free assessment tool

Nonprofit technology organization NTEN has launched a free comprehensive tool other nonprofits can use to analyze their technology practices and procedures. The tool, known as Tech Accelerate, is intended to help nonprofits with decisions, planning and investments, through data and benchmarks.

NTEN has conducted research into nonprofits' technology investments — from staffing levels to budgets — for more than a decade. Through this research, it has identified key indicators of the practices and procedures correlated with organizations utilizing technology effectively. Based on these indicators, Tech Accelerate provides users with both a "tech adoption" score (on a scale of struggling, functioning, operating or leading) and a risk assessment (low, medium or significant). NTEN says organizations already have used the tool to apply for grants or support fundraising, inform strategic planning or budgeting, and build technology roadmaps. ■

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DON'T MISS OUR ANNUAL NONPROFIT EDUCATIONAL SERIES!

Wondering how to record unrelated business income on your 990? Or maybe you'd like to know how other nonprofits are staying viable in these turbulent times? Are they exploring new revenue streams? These are just a few topics that will be covered in LaPorte's annual Nonprofit Educational Series, focused this year on strategic sustainability, which kicks off on June 8, 2023.

In its ninth year, our annual Nonprofit Educational Series was developed to provide information on a wide variety of topics that affect the nonprofit community. Topics this year include:

June – Using Data to Achieve Your Nonprofit's Objectives – Nonprofits need timely data reporting in order to measure results against benchmarks and drive their mission forward. Session highlights include data analytics capabilities commonly used by nonprofits, insight on real-time reporting and dashboards, and how to leverage that data to improve forecasting.

July – Diversified Revenue Streams – As more nonprofits explore new revenue streams, they need to be aware of how this might impact their taxable income. Session highlights include determining if an activity qualifies as unrelated business income and what this means from a tax standpoint.

While we are still in the planning stages for our August and September topics, they will also focus on topics within the umbrella of strategic sustainability. Additional information on these topics will be released at a later date.

We take seriously our commitment to share knowledge and help nonprofits keep abreast of the issues that impact them. To ensure that your organization's executive director, CFO, or board chair receives an invitation, please contact Nonprofit Industry Group leaders Jack Wiles, CPA (jwiles@laporte.com) or Dawn Laborie, CPA (dlaborie@laporte.com).