Winter 2024

Profitable Solutions for Nonprofits

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What do you know about Form 990?

Board review can benefit nonprofit governance

Most board members know — or should know — that the nonprofit organization they serve files an annual Form 990 information return with the IRS. But not every board member knows that they can, and should, review the form before it's submitted. Read on to learn why such board reviews are important and how to make them effective.

IRS makes its case

Although the IRS doesn't require nonprofit boards of directors to review their respective Forms 990, it does encourage boards to review the return. The agency believes that a correlation may exist between board review of the return and "the accuracy and effectiveness of the form in conveying the organization's mission, activities, accomplishments, finances, compensation, and business relationships and transactions." The IRS also has noted that board review of Form 990 may reflect good governance.

Of course, it's not just the IRS that might scrutinize the information in your Form 990. Potential financial supporters, from individual donors to private foundations, may examine this readily available information. In addition, the media increasingly have taken an interest.

Start a successful review

If your board doesn't already review Form 990, start now. Your board should receive the draft Form 990 to review before the IRS due date (the 15th day of the 5th month following the end of your organization's taxable year or up to six months with an extension). The board needs enough time to assign review responsibilities, conduct the review and come back with any concerns. Your staff (and possibly the CPA firm that assisted in preparing the return) then needs to respond to board inquiries and make any necessary adjustments to the initial draft before submitting the final form to the IRS.

Be sure to assign responsibilities appropriately. In nonprofits that have a formal review process for Form 990 in place, the task is often assigned to the audit or audit/

The excess benefit transaction risk

Certain nonprofits must report whether they engaged in any excess benefit transactions (EBTs) in the current or past tax years on their Forms 990. An EBT generally is a transaction where the nonprofit provides an economic benefit to a "disqualified person" that exceeds the value of what the organization received in exchange for the benefit — for example, excessive executive compensation. Disqualified persons typically are in a position to exercise substantial influence over a nonprofit's affairs.

Disqualified persons who engage in EBTs are liable for an excise tax equal to 25% of the excess benefit. If the transaction isn't timely corrected after the tax is imposed, an additional excise tax of 200% of the excess benefit is imposed. Disqualified persons aren't the only ones at risk. "Organization managers," including officers and directors, who are found to have knowingly participated in an EBT could incur an excise tax equal to 10% of the excess benefit, up to $20,000.

finance committee. The better approach may be to assign particular sections of the form to those individuals with the most relevant expertise. Your professional CPA, legal and financial advisers can provide vital assistance, especially on compliance-related matters.

Pay attention to critical areas

The core section of Form 990 is 12 pages long and there are up to 16 additional schedules. Form 990 reveals a wide range of information about an organization, but certain areas are more likely to draw the attention of the IRS and other stakeholders — for example:

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Governance. Form 990 includes a section that requests information on organizational policies — including those regarding conflicts of interest, whistleblowers, document retention, compensation and joint ventures. It also asks questions concerning the governing body and management, such as documentation of meetings and actions and whether the governing documents have undergone any significant changes. Your board should ensure that such information is properly reported to demonstrate your organization's transparency and accountability.

Compensation. Another section is devoted to compensation of officers, directors, trustees, key employees, highly compensated employees and independent contractors. Many organizations have made it into the headlines over the years because the media got wind of excessive compensation. Excessive compensation also can lead to costly excise taxes for excess benefit transactions (see "The excess benefit transaction risk," above). If an individual's position and average hours per week don't correspond with their compensation, your board needs to address the issue by, for example, ensuring adequate documentation exists to support the compensation level.

Cost allocation. Form 990 of 501(c)(3) or (4) organizations allows users to compare earned revenues with expenses, including for the organization's three largest program services. It also provides a breakdown of functional expenses among program services expenses, management and general expenses, and fundraising expenses.

Be proactive

According to the IRS, a board's review of Form 990 is a sign that the board is "proactive, informed and engaged" to ensure their nonprofit is organized and operated solely for exempt purposes. That stance — combined with the intensified interest of donors, funders and the media — make formal board review essential. ■

Nonprofits: Do your due diligence before taking out a loan

Most Americans take out loans at some point in their lives — whether it's to buy a house or to grow a small business. Even nonprofit organizations commonly apply for loans. Yet, just because other nonprofits have debt doesn't mean your organization should take out a loan — at least not before performing thorough due diligence. Here are some factors to consider.

What are the risks and rewards?

The primary drawback to a loan is that you must pay it back. In addition, you'll have to pay interest. And rates for nonprofits tend to be higher than those for businesses, because nonprofits often don't have comparable financial resources and are, therefore, considered riskier by lenders. Expenses associated with certain loans — for example, for appraisals, closing costs and attorneys' fees — may add up quickly, and your nonprofit may be required to make a significant down payment.

On the other hand, once you're approved for a loan from a reputable lender, you know you'll get the funds. And applying for a loan may require less time and effort than applying for grants, holding fundraising events or wooing major donors. Chances are you'll get the money sooner, too.

What type of loan should you consider?

Many nonprofits operate in environments where revenues peak and dip throughout the year. Bills and expenses may not correspond with this cycle, though, which can lead to cash flow crunches. For example, nonprofits often see a big jump in donations around year end or receive grants in lump sums. A revolving line of credit may be a suitable type of loan to provide needed liquidity in these situations.

Cash flow issues also can arise less predictably. A previously reliable funding source might dry up with little to no notice. Or a natural disaster could hit at a time when cash reserves are low. In such circumstances, you may want to consider a bridge loan, typically lasting no longer than one year. Bridge loans are used to fill a funding gap until more permanent financing is secured.

Longer-term loans can be an option for capital purchases (for example, equipment or facilities upgrades) or projects such as a new building. You may intend to finance the project with a capital campaign. However, campaigns can take longer than anticipated, and pledges might not materialize. A longer-term loan can help you avoid delays as the project progresses.

Similarly, you can come across mission- or operations-related opportunities that require prompt action. Perhaps office space you've had your eye on suddenly becomes available, or you encounter an attractive strategic opportunity. Bridge loans or longer-term loans may prove useful to finance these opportunities.

> Loans aren't the answer to every cash gap; if the organization has been running a budget deficit for several years, adding debt usually isn't advisable.

What's in the application?

To increase your odds of securing a loan quickly, collect necessary information before reaching out to lenders. Lenders generally want to see your plans for the loan proceeds. They'll require you to provide several years of tax filings and audited financial statements; reports of pledges, receivables, accounts payable and outstanding debt; and a description of major funding sources. You'll also need to provide a board resolution approving the loan.

Additionally, you may need to submit information about your organization's history (including articles of incorporation and bylaws), short- and long-term strategic plans, programs, funding, a list of management, and a list of the board of directors. Finally, prepare cash flow projections showing a repayment plan.

Whatever you do, act prudently

Whether your nonprofit needs to borrow money to maintain status quo or to take on a new project, know that securing a loan can be difficult and may require you to be persistent and tenacious. If you're able to get a loan, make sure to maintain excellent records and carefully manage your financial resources.

Of course, loans aren't the answer to every cash gap. If you've been running a budget deficit for several years, adding debt usually isn't advisable. Even if you can obtain a loan, the interest rate likely will be high. You're generally better off reducing expenses and raising revenue. ■

Crowdfunding comes with tax risks

Crowdfunding campaigns are designed to raise money for individuals or causes and have risen in popularity in recent years. Some nonprofits have benefited from the trend. But supporters and organizers of crowdfunding campaigns may not understand the tax implications. These can differ significantly from tax rules for traditional charitable giving. If your organization is considering a crowdfunding initiative, you need to educate yourself and your supporters.

Nonprofit uses

The IRS defines crowdfunding as a method of raising money through websites (for example, GoFundMe, DonorsChoose or Classy) by soliciting "contributions" from a large number of people. While the practice sometimes is used to fund businesses or other for-profit projects, it also can solicit donations for charitable causes and nonprofits.

Your organization might, for example, run a crowdfunding campaign for a specific organizational project or to generate funding for an urgent need among one or more of your constituents. In addition, supporters of your organization might start a crowdfunding campaign to generate donations for you.

Tax rules

Under tax law, the crowdfunding website or its payment processor may be required to report distributions of funds by filing IRS Form 1099-K, "Payment Card and Third Party Network Transactions." If so, it also must provide a copy to the recipient of the distributions.

If the crowdfunding platform distributes money raised from a campaign to the campaign's organizer, the organizer should receive a copy of Form 1099-K.

Previously, the reporting threshold was met if, during a calendar year, the total of all payments distributed to a person exceeded $20,000 in gross payments resulting from more than 200 transactions or donations. However, beginning in 2023, the threshold has dropped dramatically. Now it's met if the total of all payments distributed to a person exceeds $600 in gross payments in a calendar year — regardless of the number of transactions or donations.

If the crowdfunding platform distributes money raised from a campaign to the campaign's organizer, the organizer should receive a copy of Form 1099-K. If distributions are made directly to individuals or organizations for whom the organizer solicited funds, the form will be furnished to those individuals or organizations that receive amounts above $600.

Issuance of a Form 1099-K doesn't necessarily mean the amount of distributions is taxable to the recipient. The IRS has said that income tax consequences depend on the particular facts and circumstances.

Looking at examples

Consider, for example, Jane, a loyal supporter who starts a GoFundMe campaign that raises more than $600 for your organization and subsequently receives a Form 1099-K. If she distributed all of the money to your nonprofit, the distributions in Box 1 probably won't be taxable to Jane. However, donors to the campaign might not be able to deduct their contributions because the campaign wasn't run by your organization.

Say you launch a crowdfunding campaign to raise funds for a specific client with immediate medical needs, and the platform distributes the money directly to the client. According to the IRS, if contributions are made as a result of the contributors' "detached and disinterested generosity," and without an expectation of receiving anything in return, the amounts may be gifts and therefore aren't taxable to your client. Again, though, those contributions might not be tax-deductible for donors.

Don't be surprised

While crowdfunding certainly has some appeal for nonprofits, the tax rules can be complicated and catch organizers, supporters and recipients by surprise. Consult with your CPA to make sure you cover your bases. ■

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Website offers free HR and risk materials

The Nonprofit Risk Management Center (the Center) in Leesburg, Virginia, has launched a new website featuring an extensive array of human resources and risk materials for nonprofits. The Center generally focuses on effective risk management for nonprofits, helping organizations identify and manage risks that threaten their missions and their operations.

Its new HR and Risk Resources Center is designed to help nonprofits increase their capabilities relating to human resources and organizational risk. The searchable resources currently include checklists, infographics, worksheets and videos on topics such as how to choose and administer employee profits, how to manage employee turnover, and when to hire an interim executive director. ■

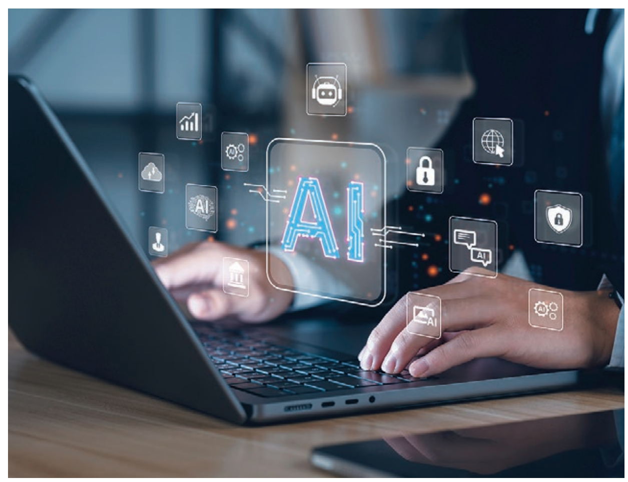
Do wealthy donors in mixed-income areas give more?

A new study published online by the peer-reviewed Public Library of Science (PLoS) examines whether the relationship between income and so-called "pro-social behavior" (such as charitable giving) depends on economic inequality. The researcher used IRS tax data to analyze income and charitable donations at the ZIP code level.

According to the study, higher-income individuals behave more "pro-socially" when local inequality is high — contrary to some previous investigations that have reached the opposite conclusion. Such individuals generally are more likely to donate and more generous in absolute terms when giving. The researcher also found that the "positive interaction" between income and inequality generally applies to volunteering. ■

Where to find nonprofit AI tools

Microsoft has released a new suite of artificial intelligence (AI) solutions and improvements to its Microsoft Cloud for Nonprofit. The tools are intended to improve how fundraisers engage with donors and manage campaigns. Microsoft says they'll help organizations overcome long-standing issues with accessing data and using it to form actionable insights based on fundraising analytics.



The new solutions include a fundraising performance dashboard that uses real-time data to provide users with interactive views of campaign performance, donor conversion and similar critical fundraising analytics. Microsoft has also added streamlined communications and engagement tools to its existing nonprofit product. Microsoft plans to release AI-based donor propensity tools that will give fundraisers the ability to do predictive forecasting of fundraising goals with data modeling and identify the donors most likely to donate to a campaign or cause or contribute a major gift. ■

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Our Commitment to Our Nonprofit Clients

The LaPorte Nonprofit Industry Group of over 35 professionals serves nonprofit clients in a variety of organizations. In addition to LaPorte's traditional audit and tax services, this multi-disciplinary group offers significant management consulting services relevant to our nonprofit clients.

While many firms have industry concentrations, LaPorte's nonprofit group comprises professionals who meet regularly to cross-train, identify best practices, review industry trends, and work together to reach collective solutions for over 250 nonprofit clients.

We are proud that 10 members of the Nonprofit Industry Group have successfully completed the AICPA Not-for-Profit Certificate I program and one member has successfully completed the AICPA Not-for-Profit Certificate II program. We also have two members of our Nonprofit Industry Group who have earned the BoardSource Certificate of Nonprofit Board Consulting.

Members of our industry group attend the annual AICPA National Not-for-Profit Industry Conference and are involved in the Louisiana Association of Nonprofit Organizations (LANO).

Nonprofit Client Base

The LaPorte Nonprofit Industry Group serves a variety of clients, including:

- Private foundations
- Public charities
- Social and country clubs
- Trade associations

Knowledge Sharing

We reach beyond our client base to support the nonprofit industry more broadly through our quarterly newsletter, Profitable Solutions for Nonprofits and through events such as the firm's nonprofit educational seminar series, which is in its eighth year. Previous seminar topics have included diversifying revenue streams, building a better board, single audit, fundraising, board governance, cybersecurity, anti-fraud internal controls, ethics and the 990, and new accounting standards. In the past we have provided numerous blogs and webcasts on the Cares Act, PPP loans and PPP loan forgiveness, the Consolidated Appropriations Act of 2021, and a series of webcasts such as "Lessons in Resilience: Learning to Survive – and Thrive – in a Pandemic." For recordings of some of our recent webcasts, please scan the QR code below.

Established in 1946, LaPorte is the largest independent accounting and business consulting firm headquartered in Louisiana, with over 190 personnel in New Orleans, Baton Rouge, Covington, and Houma, Louisiana and Houston, Texas. For more information on our Nonprofit Industry Group, contact Co-Leaders Dawn Laborie (dlaborie@laporte.com) or Jack Wiles (jwiles@laporte.com).