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News for Nonprofits

NONPROFIT AGENDAS

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Compliance counts

IRS issues guidance for excise tax on executive compensation

The passage of the Tax Cuts and Jobs Act (TCJA) in late 2017 brought several unwelcome developments for nonprofits, including a new excise tax on certain executive compensation. To answer the many questions about the tax, the IRS has issued interim guidance that is largely unfavorable for organizations with highly paid executives or so-called "excess parachute payments." These nonprofits must take the guidance in Notice 2019-09 into account when making decisions about executive compensation, severance payments and settlements.

The tax summed up

The TCJA created Internal Revenue Code provision Section 4960. It generally imposes an excise tax at the corporate tax rate (currently 21%) on any compensation of more than $1 million, paid by a nonprofit, to a covered employee in a tax year. Compensation includes most, but not all, benefits. The tax also applies to excess parachute payments made to a covered employee when he or she leaves the organization.

A payment generally is considered a "parachute" if:

1. It's contingent on the employee's involuntary "separation from employment" (termination), and

2. The total present value of all such payments to the employee equals or exceeds three times his or her average annual compensation for the preceding five years.

The excise tax applies to the excess of the parachute payment over the average annual compensation. It's imposed on the nonprofit that employs the covered employee and related organizations that also employ that same covered employee.

Who's a "covered employee"?

The new excise tax (see main article) applies only to payments made to "covered employees." But you may be surprised by who qualifies as covered and how many covered employees you have.

For starters, no minimum dollar threshold applies to the determination of who's covered. Rather, a covered employee is defined as any employee who's one of the five highest-compensated employees for the current tax year *or* was a covered employee in any tax year dating back to 2017. That means you could have more than five covered employees for this tax year and going forward.

The determination is based on remuneration paid by you — and by related organizations — in the calendar year ending with or within your taxable year. And the determination is made separately for each organization in a group of related organizations.

Even if you have no excise tax liability for a year, you should determine the five highest-compensated employees for that year. They could trigger future liability.

Related organizations may include taxable, tax-exempt and governmental entities that satisfy certain tests about the extent of the relationship between the organizations. A tax-exempt hospital, for example, might have a related for-profit testing lab that would employ one of the hospital's covered employees. The lab would then be subject to these excise tax considerations.

Some nonprofits won't be affected by Section 4960 because they don't pay excess remuneration or excess parachute payments. That doesn't mean, though, that such organizations can simply ignore the guidance. (See "Who's a 'covered employee'?" at left.)

Notable provisions

The guidance covers a range of issues, including:

Deferred compensation. Compensation generally counts toward the $1 million threshold when it vests, not when it's paid. Deferred compensation vests, at present value, when it's no longer subject to a substantial risk of forfeiture. For example, compensation hasn't vested if it's conditioned on the future performance of substantial work or an occurrence related to the purpose of the employee's work, such as completion of an organizational goal.

Covered parachute payments. The guidance provides that a parachute payment is contingent on an "involuntary" separation from employment. Examples include termination without cause or failure to renew an employee's contract. Payments that the nonprofit must pay when an executive resigns or otherwise voluntarily terminates employment wouldn't be treated as parachute payments. The right to a severance payment that vests on an involuntary separation would result in the payment being considered a parachute payment.

Calculation of the tax for multiple related organizations. When a nonprofit computes its excise tax liability for a covered employee, it must include remuneration paid by both it and any related organization that employs the employee. The liability is then allocated among each of the employers based on the percentage of the compensation paid by each. The guidance provides limited relief so a nonprofit won't get double-charged — for its own covered employee and additionally as a related organization — for the same employee.

Reporting excise tax liability. You'll report your excise tax on Form 4720, "Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code." Each employer liable for the tax, whether a nonprofit or a related organization, must separately report and pay its share of the tax. Payment is due on the 15th day of the fifth month after the end of the taxable year — May 15 for calendar-year employers.

Follow the guidance

Nonprofits can rely on the interim guidance until the IRS issues further guidance. The IRS has indicated that payment of the Section 4960 excise tax will be enforced for tax years starting after December 31, 2017. ■

Employee or independent contractor? Consider these factors

The rise of ride-sharing firms like Uber and Lyft has led to headline-making questions about whether their drivers should be treated as employees or independent contractors. But for-profit companies aren't the only ones that struggle with the issue. Nonprofits also can harbor uncertainties about whether workers are employees for whom you must withhold and pay Social Security, Medicare, and unemployment taxes.

When faced with the contractor question, a nonprofit should consider whether it controls the details of how the worker's services are performed. The IRS and the courts specifically evaluate three basic factors that establish the degree of control.

What counts?

The IRS will examine whether you have the right to direct or control how an individual performs his or her work. It's not necessary that you *actually* direct or control how the work is done — it just matters whether you have the right to do so.

Detailed instructions, training on specific procedures and methods, and evaluation systems that measure how the person performs the work will support a finding that an employment relationship exists.

Financial control weighs in

Evidence that you have the right to control the economic aspects of the work also indicates an employment relationship. The IRS is more likely to deem an individual an independent contractor if he or she:

- Incurs significant unreimbursed expenses,
- Has a major investment in his or her self-employed business with the potential of a profit or loss,
- Provides the tools or supplies for the job, and
- Is available to work for other companies or clients.

It also considers the payment method. Independent contractors typically are paid a flat fee for the contract or job, while employees generally are guaranteed a regular wage amount for an hourly, weekly or biweekly period.

Relationship type matters

How do the worker and the employer regard the relationship? For example, if you provide the worker with traditional employee benefits — such as health and disability insurance, retirement benefits, and paid vacation days — it signals your intent to treat him or her as an employee. Note, though, that the lack of benefits alone doesn't necessarily mean the worker is an independent contractor.

The duration of the relationship is relevant, too. Is it expected to continue indefinitely or only for the run of a specific project or period? Similarly, if the worker provides services that are a critical part of the business, the employer is more likely to have the right to control his or her activities. Thus, he or she is more likely to be classified as an employee.

Labels don't control the relationship — facts and circumstances do. In other words, simply describing a worker as an independent contractor in a written contract isn't determinative. The IRS will dismiss such labels if the nature of the relationship suggests otherwise.

Learning more

Are you still not sure if that worker is an employee or an independent contractor for tax purposes? The IRS has Form SS-8, "Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding," which taxpayers can file to request a determination of status. Bear in mind that the IRS is likely to find an employment relationship, which could lead to an audit and liability for back taxes. Consult with your CPA before filing this form. Rather than file SS-8, it's generally better to document the reasons supporting your decision for treating a worker as an independent contractor or employee.

Need relief?

If you ultimately conclude that you've misclassified an employee as an independent contractor, you might qualify for relief under the IRS's Voluntary Classification Settlement program. Eligible employers can reclassify workers going forward and are liable for only 10% of their payroll tax liability for misclassified employees for the most recent tax year. Contact us for more information. ■

Sharpening your organization's accounting function

Your nonprofit may be exempt from income tax, but financial and accounting responsibilities still abound: There are budgets to project and results to monitor. There are financial statements to prepare and payroll taxes to collect. And these are only some of the responsibilities that fall under the accounting umbrella. Are these tasks, and others, being handled as efficiently at your organization as they can be?

Eliminate hassles, save time

A good first step toward accounting function improvement is creating policies and procedures for the monthly cutoff of recording vendor invoices and expenses. For instance, require all invoices to be submitted to the accounting department within one week after the end of each month. Too many adjustments — or waiting for employees or departments to weigh in — can waste time and delay the completion of your financial statements.

You also may be able to save *days* at the end of the year by reconciling your balance sheet accounts each month. It's a lot easier to correct errors when you catch them early. Also, reconcile accounts payable and accounts receivable subsidiary ledgers to your statements of financial position.

Think through information gathering, recording

Designing a coding cover sheet or stamp is another step toward boosting efficiency. How so? An accounting clerk or bookkeeper needs a variety of information to enter vendor bills and donor gifts into your accounting system. Speed up the process by collecting all of that information on the invoice or donor check copy using a stamp. Route invoices for approval in a folder that lists your not-for-profit's general ledger account numbers so that the employee entering data doesn't have to look them up each time.

The cover sheet or stamp also should provide a place for the appropriate person to approve the invoice for payment. Use multiple-choice boxes to indicate to which cost center the amounts should be allocated. Documentation of the invoice's payment should also be recorded for reference. And your Development staff will want to provide the details for any donor gifts prior to your staff recording them in the accounting system.

Another tip about invoices: Don't enter only one invoice or cut only one check at a time. Set aside a block of time to do the job when you have multiple items to process.

Make full use of software

Many organizations underuse the accounting software package they've purchased because they haven't invested enough time to learn its full functionality. If needed, hire a trainer to review the software's basic functions with staff and teach time-saving tricks and shortcuts.

Standardize the financial reports coming from your accounting software to meet your needs with no modification. This not only will reduce input errors but also will provide helpful financial information at any point, not just at month end.

> *"Many organizations underuse the accounting software package they've purchased because they haven't invested enough time to learn its full functionality."*

Consider performing standard journal entries and payroll allocations automatically within your accounting software. Many systems have the ability to automate, for example, payroll allocations to various programs or vacation accrual reports. But review any estimates against actual figures periodically, and always adjust to the actual amount before closing your books at year end.

Ongoing review

Accounting processes can become inefficient over time if they aren't monitored. Look for labor-intensive steps that could be automated or steps that don't add value and could be eliminated. Also make sure that the individual or group that's responsible for the organization's financial oversight (for example, your CFO, treasurer or finance committee) *promptly* reviews monthly bank statements and financial statements for obvious errors or unexpected amounts. ■

NEWS FOR NONPROFITS

Congress mandates electronic filing

A new law intended to reform the IRS includes provisions requiring nonprofits to file their annual tax returns and unrelated business income tax returns electronically, effective for the 2020 tax year. The Taxpayer First Act also directs the IRS to make nonprofits' annual tax returns available to the public in a machine-readable format as soon as practicable.

The law gives the IRS the option to delay the application of the filing requirement for small organizations for two years. "Smaller organizations" are those with annual gross receipts of less than $200,000 and aggregate gross assets of less than $500,000 at the end of the tax year. ■

Rural areas missing out on Opportunity Zones

The Tax Cuts and Jobs Act established Qualified Opportunity Zones within low-income communities where investors can reap tax benefits by funding urban and rural development and redevelopment projects — but most rural areas aren't seeing the benefit. According to *Nonprofit Quarterly*, investors primarily have focused on commercial real estate development in large urban areas.

Of 34 Opportunity Funds reviewed in late 2018, only two even referenced rural areas in their descriptions. Experts cite several reasons for the lack of interest, including investors' unfamiliarity with rural places and players and the fact that rural real estate often doesn't appreciate to produce significant capital gains. ■

Public Service Loan Forgiveness Program pardons few

The U.S. Department of Education's Public Service Loan Forgiveness Program doesn't seem to be living up to its name. The program is intended to help nonprofit employees with student debt continue working in the sector by forgiving the balance of their student loans after 10 years of payments.

According to the *Wall Street Journal*, though, only 864 of the more than 73,000 people who had applied for debt forgiveness as of March 31, 2019, have had their loan balances forgiven. Reasons for rejection include applicants having the wrong type of loan, omitting information in applications and not making enough payments (including having an ineligible repayment plan for part of the 10-year period). ■

App "Uber-izes" food donations

A new smartphone app helps connect fresh, usable but excess food with hunger relief organizations. Through the Food Rescue US app, restaurants and organizations can arrange for a volunteer to pick up extra food and deliver it to local food banks.

The app lets volunteers determine their own volunteering hours, similar to how ride-share apps work for drivers. It frees donors from having to work around a food bank's schedule or find a food bank. And it gives the hungry access to fresher food and the same culinary preparation served to paying customers. ■

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The support you need. The service you're looking for.

Succeeding in the not-for-profit sector today requires more than a strong commitment to your mission. It takes shrewd fiscal management, careful regulatory compliance, skillful use of technology and the assistance of advisors who know the issues nonprofit organizations face and how to address them.

This is where Sechler Morgan CPAs, PLLC comes in. Our team of experienced professionals cherishes the opportunity to support nonprofit organizations, meet their management challenges and fulfill their missions. We offer a variety of specialized accounting, tax and consulting services including:

- Audit intermediary services
- Budget and policy design
- Outsourced accounting/bookkeeping
- Tax form preparation (990, etc.)
- Strategic and management consulting
- Speaking on financial literacy and other topics
- Technology and virtual system design

RESPONSIVE QUALITY

We are committed to providing responsive, personalized service to the highest quality. We take time to truly understand your Organization so that we can customize our recommendations to your specific situation. Our goal is to make your processes easier, streamline your operations and ensure your success in reaching *your* goals.

We welcome the opportunity to discuss your mission and vision so that we may assist you with our expertise. Please call us at 602-230-2700 or e-mail info@azcpa.com and let us know how we may support you. Be sure to visit our website at www.azcpa.com for additional tools and information, as well as our archive of this newsletter.

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