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Who are disqualified persons?
Understanding self-dealing rules

Don't let corporate sponsorships trip you up

News for Nonprofits

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NONPROFIT AGENDAS

SECHLER MORGAN
Certified Public Accountants, PLLC

info@azcpa.com
2418 W Barrow Drive, Chandler, AZ 85224
Tel: 602.230.2700/Fax: 602.230.2705
www.azcpa.com

Critical tax reminders for special events

After the pandemic-induced lull, many nonprofits are making up for lost time and fundraising opportunities by ramping up their special events. It's easy to get caught up in the details that come with event planning, but it's also important to remember that these functions can have tax implications. Here are some things to keep in mind so you stay on top of compliance.

Increased tax reporting

Tax reporting for an event may require different — and more — information than financial statement reporting does. If your organization adheres to Generally Accepted Accounting Principles (GAAP), you usually must report revenue and expenses related to special events on your financial statements as special event revenue (see "Your financial reporting options," on page 3). For tax purposes, though, your organization can report some of the event ticket revenue as contributions. For example, if attendees pay more for a ticket to a dinner than the dinner's fair market value (FMV), the excess would be a contribution.

Tax reporting can require more granular information, too. You report special event data on Form 990, "Return of Organization Exempt from Income Tax." If you're reporting more than $15,000 in fundraising event gross income and contributions, you also need to complete Schedule G, "Supplemental Information Regarding Fundraising or Gaming Activities."

Schedule G requires your organization to report amounts for cash prizes, noncash prizes, facilities rental, food and beverages, and entertainment. If your event includes gaming, you'll have to answer a series of multi-part questions on Schedule G, too. In addition, you'll need to allocate income and expenses between the gaming and fundraising event on Form 990.

Different IRS and GAAP treatment of items

Nonprofits often rely on donated services or facilities, as well as the work of volunteers. Although GAAP generally requires nonprofits to record such in-kind contributions and sometimes the value of volunteer time, the IRS doesn't include them in contributions or expenses.

Say a local print shop donates $1,000 in services, producing posters and programs for your event. You must report a donation of $1,000 in services on your financial statement, with a corresponding in-kind expense. But you won't report the amount in contributions or expenses for tax purposes.

Goods donated for an event, on the other hand, receive similar treatment on financial statements and tax returns. They're reported as contribution

YOUR FINANCIAL REPORTING OPTIONS

As noted in the main article, compliance reporting for special events doesn't just involve IRS tax reporting. Your nonprofit must also report these events on your financial statements.

When it comes to financial reporting for special events, Generally Accepted Accounting Principles (GAAP)-compliant nonprofits typically have three options for reporting in the statement of activities:

1. Report the gross revenue as special event revenue and the cost of direct benefits to donors as a functional expense in the expense section,

2. Report gross revenue as special event gross revenue and the cost of direct benefits to donors as a separate line item deducted from special event gross revenue, or

3. Report the revenue as part special events revenue (for the value of the benefit the donor received) and part contribution (for the excess paid). The cost of direct benefits is deducted from the special event revenue as a separate line item.

If the event isn't a major or integral activity for your organization, you can simply report the amounts as gross or net on your statement of activities.

revenue and, when used, expenses. For example, if a vendor donates golf balls and tees for a golf outing, the donation is a contribution. When the items are used at the event, they're an expense.

While GAAP generally requires nonprofits to record in-kind contributions and the value of volunteer time, the IRS doesn't include them in contributions or expenses.

Disclosure to donors

Donors may be confused about the tax benefits they receive from participating in a special event. That's especially true if it's their first time participating, and they're accustomed to simply deducting the full amount of their cash donations. They might not be aware that their deductible contributions are reduced by the FMV of the benefit they receive (for example, the meal, entertainment, round of golf or souvenir t-shirt).

It's generally up to you to report the value donors receive in a written statement, reminding them to deduct only the excess of their payment over the FMV. Specifically, you must provide the disclosure for payments of more than $75. Note that it's the initial payment amount that triggers the obligation — not the amount of the deductible portion. Failure to make the disclosure can result in a penalty of $10 per contribution, up to $5,000 per fundraising event.

Even if not legally required, it's wise to routinely provide special event participants with a statement of the benefits they receive. You'll make it easier for them at tax time, which could result in the kind of goodwill that leads to future support. You don't want them to associate your organization with tax hassles.

Ease the burden

Whether for tax or financial statement purposes, you need to carefully track revenues, expenses and related documentation for your special events. We can help ensure that you have the processes and procedures in place to easily collect necessary data.

Who are disqualified persons?

Understanding self-dealing rules

The IRS strictly prohibits self-dealing between private foundations and so-called "disqualified persons." Potential penalties for the disqualified person and foundation staff are stiff. Here's what you need to know to avoid liability.

Stiff penalties

The Internal Revenue Code imposes a minimum 10% excise tax on disqualified persons on the amount involved in a self-dealing transaction. "Foundation managers" — that is, officers, directors or trustees — who knowingly participate in acts of self-dealing face a 5% tax on the amount involved. Notably, participation on the part of foundation managers includes not only affirmative acts, but also silence or inaction where there's a duty to speak or act.

If not corrected, the tax on a self-dealing transaction on disqualified persons other than foundation managers soars to 200%. When this extra tax is imposed, an excise tax of 50% of the amount involved is also imposed on any foundation manager who refuses to agree to part or all of the correction of the self-dealing act.

Important definitions

Who exactly are disqualified persons? The IRS defines them as:

- Substantial contributors (donors who give in excess of prescribed limits),
- Foundation managers,
- Owners of more than 20% of certain organizations that are substantial contributors,
- Family members of the above,
- Corporations or partnerships in which any of the above hold more than 35% voting power,
- Trusts or estates in which persons above hold more than a 35% beneficial interest,
- Certain private foundations effectively controlled by the person or persons in control of the foundation at issue, and
- Governmental officials.

And what exactly is an act of self-dealing? According to the IRS, it includes the:

- Sale, exchange or leasing of property,
- Lending of money or other extension of credit,
- Furnishing of goods, services or facilities,
- Payment of compensation or expenses to a disqualified person, and
- Transfer or use of the foundation's income or assets by or for the benefit of a disqualified person.

Certain payments to government officials and transactions between organizations controlled by a private foundation may also be taxable self-dealing.

Exceptions

The IRS recognizes an exception to self-dealing if the benefit to a disqualified person is only "incidental or tenuous." The exception is narrowly interpreted, but it has been granted in a variety of circumstances.

For example, the exception was triggered by a scholarship awarded under a private foundation's scholarship program for the children of employees of a substantial contributor. And the exception permitted a disqualified person's participation "to a wholly incidental degree" in the fruits of a charitable program of broad public interest.

Additionally, compensation paid to disqualified persons is not an act of self-dealing if the payments are for reasonable and necessary services to carry on the foundation's exempt purposes.

Signs of self-dealing

IRS auditors looking for evidence of self-dealing won't simply rely on a private foundation's tax return. For example, they'll review grants to determine if any disqualified person has any connection to the recipient. Auditors also will review all transactions between the foundation and disqualified persons to determine if any merit further review. Relevant evidence might include contracts, meeting minutes, bank documents, interviews, facility tours, and personnel and payroll records.

The IRS will establish the location of all of a foundation's assets, too — including those that have fully depreciated. They'll look at whether a disqualified person is using foundation property, how the organization disposes of depreciated assets, and if any assets have been given to disqualified persons.

Proceed with caution

The costs of self-dealing run high, and they extend beyond the monetary penalties. Reputational harm could prove even more painful in the long run. When in doubt, run transactions involving disqualified persons past your professional advisors.

Don't let corporate sponsorships trip you up

With some financial experts predicting that a recession looms on the horizon, corporate sponsorship dollars can be appealing. However, nonprofit organizations need to take care when crafting such arrangements — or possibly face an unexpected tax bill.

What are qualified sponsorship payments?

Under the Internal Revenue Code, qualified sponsorship payments aren't subject to unrelated business income tax (UBIT). The term refers to payments of money, property transfers or the performance of services by a business without an expectation or arrangement that the business will receive any substantial return benefit in exchange. A substantial return benefit generally is any benefit other than an acknowledgment. It includes advertising; goods, facilities, services or other privileges; the rights to the nonprofit's trademark or logo; and exclusive provider arrangements.

Sponsored activities may include a single event, a series of related events, an ongoing activity or continuing support of a nonprofit's operation. A qualified sponsorship payment doesn't have to relate to the organization's exempt purpose.

Note that an exclusive *sponsor* arrangement isn't a problem. You can agree that a certain sponsor will be the only sponsor for your activity. But you can't, for example, agree to limit the availability of products provided by the sponsor's competitors at your event. The latter scenario usually results in a substantial return benefit.

What aren't qualified sponsorship payments?

If a sponsor will receive a substantial return benefit, only the part of the payment that exceeds the fair market value (FMV) of the benefit is a qualified sponsorship payment. If you can't establish that the payment exceeds the FMV, no portion of the payment constitutes a qualified sponsorship payment. Qualified sponsorship payments also don't include payments:

- Contingent on the degree of public exposure, such as the level of attendance at your event, broadcast ratings or similar factors,
- That entitle the sponsor to use its name or logo in your regularly scheduled and printed periodicals, such as magazines or e-newsletters (as opposed to materials published only in connection with a specific event), or
- Related to convention or trade show activities.

If part of a payment is qualified and part of it isn't, the IRS will treat the portions as separate payments. Income received in exchange for such sponsor benefits is generally subject to UBIT.

Are advertising and acknowledgments different?

The IRS has pinpointed the primary issue presented by corporate sponsorships: distinguishing qualified sponsorship payments and the related acknowledgment of sponsors from the sale of advertising. Advertising is defined as any transmitted, published, displayed or distributed message or programming material that promotes or markets a business, service, facility or product.

An acknowledgment is intended only to identify the sponsor — not promote its products, services or facilities. Acknowledgments don't have to be as bare bones as you might expect, though. They can include the sponsor's logo, slogans, brand or trade names; locations and phone numbers; product service listings; and value-neutral descriptions of its product line or services. An acknowledgment also can include a sponsor's website URL. It can link to the website's home page, but not to the page for a particular product or service.

Try to avoid comparative or qualitative descriptions — for example, "the best software for nonprofits." The IRS considers a message that includes comparative or qualitative language *and* an acknowledgment to be advertising.

Finally, your acknowledgments shouldn't include price information, indications of savings or value, or an endorsement or inducement to buy, sell or use the sponsor's products or services. But mere display or distribution of a sponsor's product at a sponsored activity isn't considered to be such an inducement.

Do the right thing

A corporate sponsorship executed correctly can benefit both the nonprofit that receives funding and the sponsor that receives valuable branding opportunities. But if it's not done right, your organization could end up paying UBIT. Contact us to help you navigate the process.

News for Nonprofits

Salary transparency gains steam

The American Alliance of Museums (AAM), in Washington, D.C., is now requiring job postings on its Job HQ board to include salary ranges. The AAM itself has posted salary information for years. Urging museums to do the same is a step toward more equitable hiring, retention and promotion. The mandate took effect in November 2022.

The move comes as the disclosure of salary ranges is becoming mandatory in certain cities and states. For example, the AAM requirement kicked in shortly after implementation of a law in New York City that requires employers with four or more employees to include salary information in job listings. Similar laws have been enacted in California, Colorado, Connecticut, Maryland, Nevada, Rhode Island and Washington and several municipalities. Even when not required, nonprofits would be wise to take jobseekers' salary transparency expectations into account.

Why "social giving" is growing in popularity

Giving by so-called "social donors" who participate in auction or gala events, peer-to-peer fundraising events, challenges, and giving/awareness days grew by 6% between 2018 and May 2022. And 29% of U.S. adults surveyed self-identified as a social donor in 2022. That's according to the *2022 Giving Experience Research Study: Understanding Evolving Donor Expectations* released by Indianapolis-based OneCause, a fundraising software company.

About one-third of approximately 1,000 social donors surveyed reported participating in events; 39% in runs, walks and rides; 35% in giving days; and 25% in challenges. Thirty-eight percent donated or requested donations for an occasion such as a birthday or a memorial. After a 2021 surge due to giving for COVID-19 relief, though, the average donation dropped to $1,010 from $1,277. Millennials continue to make more social donations — an average increase of $7 from 2021. All other generations cut their average annual social donation by $30 or more.

Apple litigation leads to nonprofit cybersecurity funding

Technology behemoth Apple's lawsuit against NSO Group — an Israeli spyware company that has been identified as a threat to U.S. national security — is leading to some promising developments when it comes to nonprofits' cybersecurity. Apple has a made a $10-million grant to support organizations that investigate, expose and prevent highly targeted cyberattacks, including those by companies such as NSO Group. It will similarly earmark any damages it's awarded in the lawsuit.

The grant will go to the Ford Foundation's Dignity and Justice Fund (DJF), a pooled grantmaking fund intended to make high-impact grants to advance social justice and equity. The DJF will award grants to groups working to prevent cyberattacks and cybersurveillance on nonprofits, academics, activists and others. The initial awards will fund approaches to help expose mercenary spyware and protect potential targets.

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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2418 W Barrow Drive
Chandler, AZ 85224
www.azcpa.com