

Tax Guide for Nonprofits

Edition 4.2

Stephen Fishman, J.D.

Table of Contents

Chapter 1 – Nonprofits and the IRS	1
Learning Objectives	1
Introduction.....	1
What Do We Mean When We Say “Nonprofit”?	1
Tax-Exempt Nonprofits	1
Section 501(c)(3) Charitable Organizations	2
Private Foundations and Public Charities	3
The Life Cycle of a Nonprofit.....	3
Creating Your Legal Entity	4
Obtaining Tax-Exempt Status	4
Ongoing Compliance	5
Limitations on Your Nonprofit’s Activities.....	6
Documenting and Disclosing Contributions	6
Annual Tax Filings	7
Record Keeping	7
Ending Your Nonprofit.....	8
IRS Audits	8
What Is an Audit?	8
Who Gets Audited.....	8
Types of Audits.....	9
Audit Outcomes	13
Appealing an IRS Audit.....	14
Review Questions.....	15
Review Answers	17
Chapter 2 – Annual IRS Filings – The Form 990	19
Learning Objectives	19
Introduction.....	19
The Nuts and Bolts of the Filing Process.....	19
Why an Information Return?	19
Who Is Exempt?	20
Which Form Should You File?.....	21
When to File Your Return.....	22
When to File Your Return	22
How to File Your Return.....	23
What If You Don’t File?	23
The 990-N Postcard Filing—As Simple as It Gets.....	24
How to Complete and File Form 990-N	25
Form 990-EZ: The E-Z Way Out	26
General Background Information.....	27
Parts I and II: Financial Information.....	28
Part III: Program Accomplishments	33
Part IV: ODTKE Disclosure and Compensation	34
Parts V and VI: Additional Information.....	36
Part VI: Payments to Key Employees or Contractors.....	38
Signature Block	38
Schedules.....	38
Form 990: Just Hold Your Nose and File It.....	39
Do You Really Have to File Form 990?	40
Who Should Prepare Form 990?	41
An Overview of the Form 990.....	41
Getting Ready for Form 990.....	43
Are Your Management Practices Up to Snuff?	45
Identify and Disclose Family and Business Relationships.....	46

Table of Contents

Letting the Public See Your Report Card: Disclosure of Form 990	47
Public Inspection of Returns.....	48
Furnishing Copies of Returns.....	49
What If Someone Harasses You?	49
Penalties for Failure to Comply	50
Notifying the IRS If You Terminate, Merge, or Contract Your Nonprofit.....	50
Which Form to File.....	51
When the Return Is Due.....	51
Information You Must Disclose.....	51
Significant Contraction of Your Nonprofit.....	52
What to Do If the IRS Has Revoked Your Nonprofit’s Tax-Exempt Status.....	52
Reinstating Tax-Exempt Status.....	52
If Your Nonprofit Was Previously Reinstated (Not Retroactively)	55
Review Questions.....	56
Review Answers	58
Chapter 3 – Record Keeping and Accounting.....	61
Learning Objectives	61
Introduction.....	61
Why Keep Financial Records?	61
Preparing Annual IRS Information Returns.....	61
Showing You’re Fulfilling Your Nonprofit Mission.....	61
Showing You Qualify as a Public Charity.....	62
UBIT	62
Preparing Financial Statements	62
Monitoring Your Budget	62
What Does the IRS Require?.....	63
A Tax Year	63
An Accounting Method.....	64
A Record of Income and Expenses	65
A Paper Trail.....	71
Asset and Liability Records.....	73
Employment Tax Records.....	73
How Long Should Records Be Kept?	74
Do You Need an Independent Audit?	75
Minding the GAAP	76
Required Financial Statements	76
Accounting for Restricted Funds	77
Recording Pledges and Donations	77
Review Questions.....	79
Review Answers	81
Chapter 4 – Volunteers, Employees, and Independent Contractors	83
Learning Objectives	83
Introduction.....	83
Volunteers—The Backbone Workforce of Nonprofits.....	83
What Is a Volunteer?	84
Volunteer Work—From Director to Intern	84
Reimbursing Your Volunteers—Know the Rules.....	84
Accountable Plans—The Key to Success With the IRS	85
Local Transportation Costs	89
Travel and Entertainment Expenses.....	89
Unreimbursed Volunteer Expenses	90
Requirements for Deducting Unreimbursed Expenses.....	90
Substantiation of Volunteer Expenses.....	92
Benefits and Freebies—How to Show Your Appreciation Tax Free.....	93
Working Condition Fringe Benefits	93

Table of Contents

De Minimis Benefits—Those Token Freebies.....	94
Tax-Free Benefits for Volunteer-Employees.....	95
Paid Help: Employees and Independent Contractors.....	96
What’s the Big Deal?	97
How to Tell the Difference.....	98
The Safe Harbor Rule for Independent Contractor Status.....	101
Getting an IRS Advance Determination.....	102
Classifying Corporate Officers and Directors.....	103
Hiring Independent Contractors.....	103
Procedures for Hiring Contractors.....	103
Your Tax Reporting Obligations.....	106
Filing Out Form 1099-MISC.....	107
Filing Paper Form 1099s.....	107
Hiring Employees.....	108
The Tax Collector Role.....	108
Reimbursing Your Employees.....	110
Obamacare (Affordable Care Act) and Nonprofit Employers.....	111
Is Your Nonprofit a “Large Employer”?.....	112
Independent Contractors Not Covered by Employer Mandate.....	112
Penalties Under the ACA.....	112
Small Business Health Care Tax Credit.....	113
Review Questions.....	114
Review Answers.....	116
Chapter 5 – Charitable Giving – The Basics and Cash Donations.....	119
Learning Objectives.....	119
Introduction.....	119
Your Role as a Nonprofit.....	119
Threshold Requirements for Deducting Donations.....	120
The Donee Side—It Must Be a Qualified Organization.....	121
The Donor Side—Only Those Who Itemize Can Deduct.....	122
Annual Limits on Charitable Deductions.....	124
Pease Limitation on Itemized Deductions.....	124
What Can a Donor Contribute?.....	124
When Is a Contribution Made for Tax Purposes?.....	125
Special Gifts—Earmarked, Restricted, and Conditional.....	126
Earmarked Gifts.....	126
Restricted Gifts.....	127
Conditional Gifts.....	127
If Your Nonprofit Provides Goods or Services.....	128
Cash Contributions.....	129
Contributions of \$250 and Less.....	129
Contributions of \$250 and More.....	130
Cash Gifts From IRAs.....	131
Interest-Free Loans.....	132
Quid Pro Quo Contributions.....	132
Disclosure Statements.....	133
Exceptions to the Quid Pro Quo Rules.....	135
Charity Auctions.....	138
Review Questions.....	139
Review Answers.....	141
Chapter 6 – Property Donations.....	143
Learning Objectives.....	143
Introduction.....	143
Annual Deduction Limit for Property Donations.....	143
Long-Term Capital Gain Property.....	144

Table of Contents

Ordinary Income and Short-Term Capital Gain Property.....	144
Valuing Property Donations—An Art, Not a Science.....	145
Your Nonprofit’s Role in Determining Value.....	145
Basic Valuation Rule: Fair Market Value	145
Different Types of Property Donations.....	146
Clothing and Household Items	146
Vehicles—Used Cars, Boats, and Aircraft	147
Stock and Other Securities	149
Real Estate.....	151
Art, Antiques, Collectibles, and Unusual Gifts.....	152
Conservation Easements.....	154
Food Inventory.....	155
Business Inventory	155
Corporate Inventory and Equipment.....	155
Documenting Property Donations.....	156
Deadline for Providing Documentation	156
Property Worth Less Than \$250.....	156
Property Valued at \$250 to \$500.....	157
Property Valued at \$500 to \$5,000.....	158
Property Valued at \$5,000 or More.....	159
When a Nonprofit Sells Donated Property—IRS Form 8282	161
Documentation Rules for Cars, Boats, and Airplanes	166
Review Questions.....	170
Review Answers	171
Chapter 7 – Excessive Compensation, Sweetheart Deals, and Other Ways to Get in Trouble With the IRS	173
Learning Objectives	173
Introduction.....	173
A Nonprofit Is Not a Personal Piggy-Bank.....	173
The IRS Intermediate Sanctions Minefield.....	174
Disqualified Person + Excess Benefit = IRS Sanctions	175
Automatic Excess Benefits.....	176
Loans With Insiders	176
Transactions With Disqualified Persons—How to Avoid Problems With the IRS	177
Identify Your Nonprofit’s Disqualified Persons	177
Follow IRS-Approved Procedures	179
Have a Conflict of Interest Policy.....	181
Excessive Compensation for Services: The Most Common Excess Benefit	182
Preapproval of Compensation.....	182
What Is Reasonable Compensation?	183
What Is Included in Compensation?.....	184
Using Comparable Compensation Data	185
Document All Taxable Compensation Paid to DPs	187
Reimburse Employee DP Expenses Under an Accountable Plan	189
Correcting and Reporting Excess Benefit Transactions	190
The IRS’s Sentence of Death: Revocation of Tax-Exempt Status	191
Private Inurement	191
Private Benefit	192
Review Questions.....	195
Review Answers	197
Chapter 8 – Nonprofits That Make Money and UBIT	199
Learning Objectives	199
Introduction.....	199
What Is UBIT?	199
Is the Activity Related to Your Mission?.....	200

Table of Contents

Is the Activity a Business?	202
Is the Activity “Regularly Carried On”?.....	203
Activities Exempt From UBIT	204
When Your Volunteers Do the Work.....	204
Thrift Shops and Donated Merchandise	204
Donor Lists	205
Convenience Activities.....	205
Business Sponsorships.....	205
Rental Income, Capital Gains, and Investment Income.....	206
Low-Cost Giveaways	207
Research Income.....	207
Bingo Games.....	208
Periodical Advertising Income	208
Do You Owe UBIT?	209
Filing UBIT Tax Returns.....	210
Deadline for Filing.....	211
Failure to File Form 990T.....	211
Contents of Form	211
Paying UBIT	211
Review Questions.....	213
Review Answers	214
Chapter 9 – Lobbying and Political Campaign Activities	215
Learning Objectives	215
Introduction.....	215
Lobbying by Nonprofits—What’s Allowed and What’s Not	215
What Is Lobbying?	216
Not All Advocacy Is Lobbying.....	217
Nonpartisan Education Is Not Lobbying.....	218
How Much Lobbying Is Too Much?	219
Reporting Your Lobbying Time and Expenses.....	221
Lobbying via the Internet.....	221
If You Receive Federal Grants	222
Political Campaign Activities—An Absolute Ban	222
What Activities Are Prohibited	223
Voter Education, Voter Registration, and Get-Out-the-Vote Drives	223
Candidate Appearances.....	223
Voter Guides.....	225
Individual Activity by Directors, Officers, and Employees	225
Issue Advocacy Versus Political Campaign Activity	226
Business Activity as Political Campaign Activity	226
Websites.....	227
Consequences of Violating the Rules.....	228
Getting Around the Restrictions.....	229
Forming a Social Welfare Organization	229
Forming a PAC	230
Review Questions.....	231
Review Answers	233
Chapter 10 – Help Beyond This Book.....	235
Learning Objectives	235
Introduction.....	235
Help From the IRS	235
Other Helpful Publications and Websites.....	237
Researching the Tax Law	238
Review Questions.....	242
Review Answers	243

Table of Contents

Appendix – Forms	245
Sample Conflict of Interest Policy	245
Rebuttable Presumption Checklist	245
Family and Business Relationship Questionnaire	245
Expense Report	245
Glossary	253
Index	259