Accounting & Tax Update

Presented by: Paul Shifrin & Lori Burghauser

Accounting Update

- Revenue Recognition Project
- NFP Financial Reporting Project
- Single Audit Transition
- FASB Update

Revenue Recognition Project

- Overview
- Contract based
- Five step model
- Transition and effective date

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Revenue Recognition – Overview

- Rules vs. Principles
- Industry specific guidance
- Abuse driven guidance
- Where are we headed?

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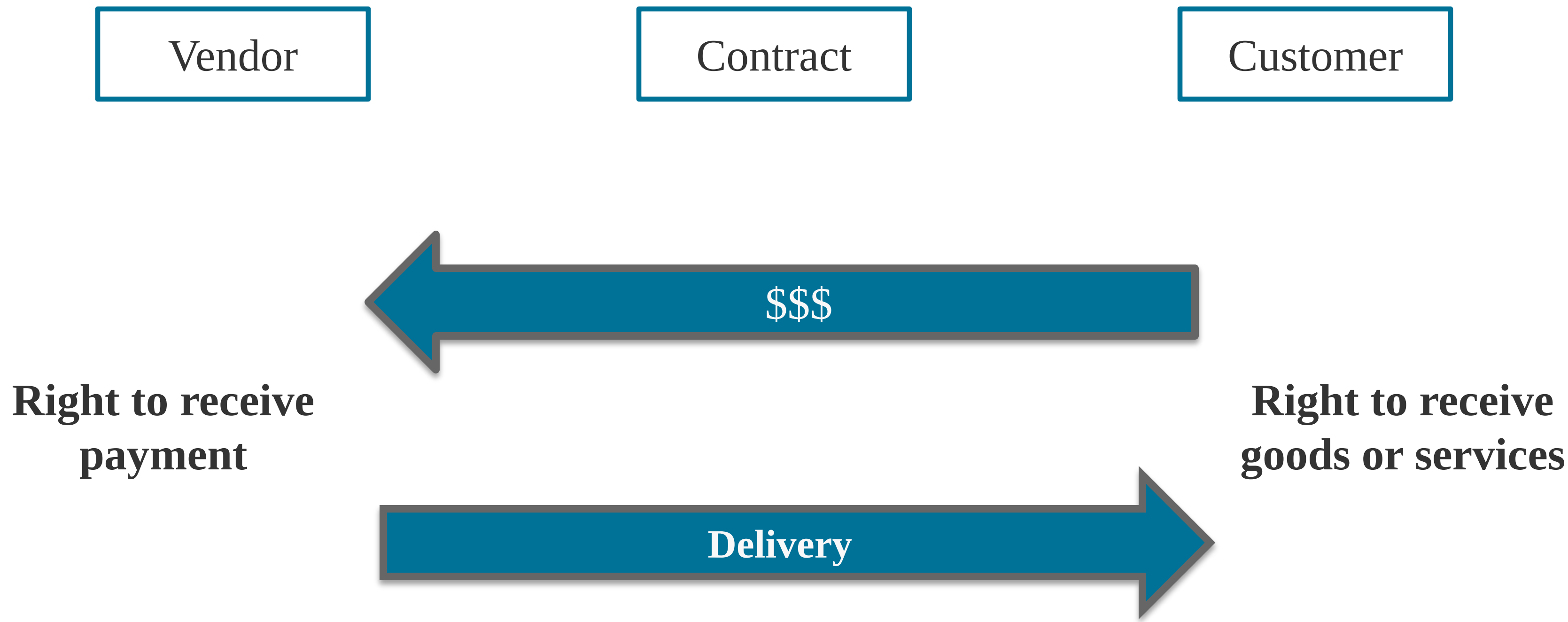
Revenue Recognition – New Approach – Contracts



Asset Based

Five Step Model

1. Analyze the contract
2. Identify performance obligations
3. Determine transaction price
4. Allocate transaction price among deliverables
5. Recognize revenue as items delivered

Transition and Effective Date

- Effective for periods beginning after 12/15/2017
  - Capture of data in system
- Two transition methods
  - Retrospective to each prior reporting period
  - Retrospective with cumulative effect recognized at date of initial application

FASB NFP Financial Reporting Project

- Expense presentation
- Intermediate operating measure
- Net asset classification
- Cash flow presentation
- Disclosures

Single Audit Transition

- A-133 Subpart A 2 CFR 200 Subpart F
- Effective for fiscal years beginning after 12/26/14
  - 1/1/15 – 12/31/15
  - 7/1/15 – 6/30/16
  - 10/1/15 – 9/30/16

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Key Changes

- Auditor Selection
- Increase in Audit Threshold
- Extent of Compliance Testing
- Determination of Major Programs
- Criteria for “Low Risk” Auditee
- Audit Reporting
- Audit Resolution

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FASB Update

- Extraordinary and Unusual Items
- Going Concern
- Discontinued Operations

Contact Information

Paul Shifrin
Director
pshifrin@scandh.com

Visit: www.scandh.com
Phone: (800) 921-8490
Email: sch_group@scandh.com

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Tax Update

- Summary of currently expired tax provisions impacting tax exempt organizations
- News from the IRS
- 2014 Changes to Form 990 and Schedules
- Sponsorships
- Advisory Committee on Tax Exempt Organizations Recommendations
- Affordable Care Act – Employer Shared Responsibility Reporting
- Camp Proposal in Congress

Expired Tax Provisions currently in Extender Bills

- Exclusion from a tax-exempt organization’s unrelated business income of interest, rent, royalties and annuities paid to it from a controlled entity
- Tax-free distributions from individual retirement plans (“IRS’s”) for charitable purposes
- Enhanced charitable contributions of food inventory
- Deduction for contributions of capital gain real property for conservation purposes
- Basis adjustment rule for stock of an S corporation making charitable contributions of property

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News from the IRS

- Old method of auditing exempt organizations –slow and unproductive (market segments)
- Change in focus to data-driven approach using filters – to look at how certain issues are presented in returns
- Significant reduction in outstanding 1023 applications partially due to new Form 1023-Z
- Form 1023-Z applications not just rubber stamped
- IRS expects to give new exempt organizations a few years of operations and then sample to ensure that organizations are operating in adherence to exempt purposes – expect some audits

News from the IRS – Proposed Regulations on Charitable Contributions

- Current law – individuals who give $250 or more to charity must obtain a contemporaneous written acknowledgement from the charity that contains the following information: (1) amount of cash and description of any property contributed; (2) whether any goods and services were provided by the donee organization in consideration for the contribution; and (3) a description and good faith estimate of the value of any goods and services provided by the donee organization
- Proposed regulations would allow donee organization to provide this information to the IRS and donor by February 28th of the year following the calendar year the contribution was made
- Donee reporting is optional

IRS Areas of Interest

- Exemption issues
- Tax Gap – employment taxes and unrelated business income tax (UBIT)
- International issues
- Protection of assets – private inurement, self-dealing

Changes to Core Form 990 – Relatively Minor

- Part VII, Section A – Compensation – Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees – clarify that reportable compensation should not be treated as deferred if deferred from the calendar year ending with or within the tax year to a date that is not more than 2 ½ months after the end of the calendar year ending with or within the tax year.
- Part XI – Reconciliation of Net Assets – Clarification that the amounts reported on lines 5, 6 and 8 should match the corresponding amounts in the organization's financial statements (unrealized gains/losses, donated services and use of facilities, and prior period adjustments)

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Changes to Schedule A- Substantial Revisions

- Substantial revisions to address supporting organizations
- Doubled in size from four page to eight page form
- New sections IV and V for supporting organizations
- Seven new pages of instructions

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Supporting Organizations

- **Type I Supporting Organization** – "operated, supervised or controlled by" the specified public charity. The specified public charity has a substantial degree of direction over the policies, programs and other activities of the supporting organization similar to a parent/subsidiary relationship. Majority of the officers, directors, trustees of the supporting organization are appointed by the governing body of the specified public charity.
- **Type II Supporting Organization** – "supervised or controlled in connection with" the specified public charity. The specified charity and the supporting organization have common supervision and control similar to a brother/sister corporation relationship. Generally there are common directors or trustees

Supporting Organizations

- **Type III Supporting Organization** – “operated in connection with” the specified public charity.
  - Prior to the Pension Protection Act this relationship was established if the supporting organization satisfied both a responsiveness test and an integral part test.
  - Pension Protection Act added additional tests
  - Final regulations issued December 2012

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Functionally Integrated Type III - Supporting Organizations (Three Ways)

- Substantially all activities directly further the exempt purposes of one or more supported organizations to which the organization is responsive and but for the involvement of the organization the supported organization would be performing the activities, or
- Parent organization of the supported organization – exercises substantial degree of direction over the programs, policies and activities of the supported organization. Majority of officers, directors, or trustees of the supported organization are appointed, directly or indirectly, by the governing body, or officers of the supporting organizations or
- Supports a government entity (further regulations due)

Non-functionally Integrated Type III Supporting Organizations

- Must meet (1) a minimum payout requirement and (2) an attentiveness test or an alternative test for a trust that existed prior to 11/20/70
- Minimum payout requirement – greater of 85% of adjusted gross income or 3.5% of average net value of non-exempt use assets – at least 1/3 of distributable amount must be to one or more “attentive” supported organizations to which the organization is responsive
- Attentiveness Test
    - Support is 10% or more of the supported organization’s total support (or in the case of a particular department or school of a university, hospital, or church, the total support of the department or school) received during the supported organization’s tax year ending before the beginning of the organization’s tax year
    - Amount of support necessary to avoid interruption of a particular function or activity of the supported organization (program must be a substantial one)
    - Sufficient attention is demonstrated by “all pertinent factors” including the amount of support and evidence of actual attentiveness.

2014 Form 990 Schedule A New Part IV, Section A – Questions (All Supporting Orgs)

- Are all the supported organizations listed by name in the organization's governing documents?
- Did the organization have any supported organization that do not have an IRS determination status under IRC §509(a)(1) or §509(a)(2)?
- Did the organization have a supported organization described in IRC §501(c)(4), §501(c)(5) or §501(c)(6)?
- Was any supported organization not organized in the U.S?
- Did the organization add, substitute, or remove any supported organizations during the year?
- Did the organization provide support to anyone other than its supported organizations, individuals in their charitable class or other or other supporting organizations that also support or benefit one or more of the organization's supported organizations?

2014 Form 990 Schedule A
New Part IV, Section A – Questions - Continued

- Did the organization provide a grant, loan, compensation, or similar payment to a substantial contributor, family member of a substantial contributor, or 35% controlled entity with regard to a substantial contributor?
- Did the organization make a loan to a disqualified person?
- Was the organization controlled by one or more disqualified persons other than foundation managers and organizations described in IRC §509(a)(1) or (2) at any time during the year?
- Did the organization have any excess business holdings during the year?
- Has the organization accepted a gift from a person who directly or indirectly controls the governing body of a supported organization, a family member of the above or a 35% controlled entity of the above?

Schedule A, New Part IV Section B

- **Applies to Type I Supporting Organizations**
  - Did the supported organization have the power to regularly appoint or elect at least a majority of the organization’s directors or trustees at all times during the year?
  - Did the organization operate for the benefit of any supported organization other than the supported organization(s) that operated, supervised, or controlled the supporting organizations?

Schedule A, New Part IV Section C

- **Applies to Type II Supporting Organizations**
  - Were the majority of the organization's directors or trustees also a majority of the directors or trustees of the organization's supported organizations during the tax year?

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Schedule A, New Part IV Section D

- **Applies to all Type III Supporting Organizations**
  - Did the organization meet is notification requirement to its supported organizations? (by last day of fifth month of the organization’s tax year - written notice describing the type and amount of support provided during the prior tax year, copy of most recently filed Form 990 and copy of governing documents if not previously provided)
  - Was there a close and continuous working relationship? (were the organization’s officers, directors or trustees either (1) appointed or elected by the supported organization or (2) serving on the governing body of a supported organization?)
  - How did the supported organization have a significant voice in the organization’s investment policies and in directing use of the organization’s income/assets at all times during the tax year?

Schedule A, New Part IV Section E

- **Applies to all Type III Functionally Integrated Supporting Organizations**
  - How did the organization satisfy the integral part test?
    - Satisfies the activities test
    - Is the parent of each of the supported organizations
    - Supports a governmental entity (Notice 2014-4)
  - If activities test is satisfied
    - Did substantially all of the organization's activities further the supported organizations' exempt purposes?
    - But for the organization's involvement, would one of more of the supported organizations have engaged in the activities
  - If parent test satisfied
    - Did the organization have the power to regularly appoint or elect the majority of the supported organizations' officers, directors or trustees?
    - Did the organization exercise a substantial degree of direction over the policies, programs and activities of each of its supported organizations?

Schedule A, New Part V

- **Applies to Type III Non-Functionally Integrated Supporting Organizations**
- Similar to Private Foundation provisions in Form 990-PF
  - Section A: Adjusted net income calculation
  - Section B: Minimum asset amount calculation
  - Section C: Distributable Amount calculation
  - Section D: Distributions
  - Section E: Distribution allocations
- Note that Type III Non-Functionally Integrated Supporting Organizations must distribute 85% of adjusted net income or 3.5% of the fair market value of non-exempt use assets

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2014 Schedule B Schedule of Contributors

- Revised form instructions to clarify that a public charity can use the greater than 2% threshold only if the organization completes Schedule A, Part II to show that it qualifies as a public charity under IRC §170(b)(1)(A)(vi)

Changes to Schedule L Transaction with Interested Persons

- Uniform definition of “interested persons” for Part II, III and IV of Schedule L

Schedule L - Definition of Interested Persons

- Schedule L , Part 1 – no change
  - Disqualified persons under IRC §4958:
    - Substantial contributor to the organization
    - Member of the family of a substantial contributor
    - A 35% controlled entity of a substantial contributor
  - Disqualified person under this definition does not include:
    - Any organization described in paragraph (1), (2) or (4) of IRC §509(a) (generally a publicly supported organization)
    - Supported organization of the organization

Schedule L – New Definition of Interested Person Parts II-IV

- For Schedule L, Parts II-IV –expansion of definition to include:
  - The founder of the organization
    - The founder’s family members
    - Includes sponsoring organizations of VEBAs
  - Substantial contributors reported in Schedule B
    - Family members of substantial contributors
  - 35% controlled entities of substantial contributors or their family members (also includes controlled entities of any current or former officer, director, trustee, or key employee)

Schedule L – Other Changes

- Uniform "reasonable efforts" definition applies to all parts of the form (example of reasonable effort is to annually distribute questionnaire to anyone the organization believes to be an interested person requesting information to determine if a transaction is reportable)
- Part I (excess benefit transactions – must identify in Part V any organization managers that knowingly participated in the excess benefit transaction
- Part II – clarifies that split-dollar life insurance arrangements are loans reportable in Part II
- Part IV – new reporting exception for transactions with publicly-traded corporation in the ordinary course of business, on the same terms as are generally offered to the public

Schedule L – Definition of Interested Person Parts II-IV

- For Schedule L, Parts II-IV **– removed** from definition of interested persons (contraction):
  - **Removed from Part II definition**
    - Highest compensated employees
    - Section 4958 disqualified persons
    - Contributing employers of VEBAs
  - **Removed from Part IV definition**; entity of which a current or former officer, director, trustee, or key employee, of any family member of any of the above was serving as a
    - Director, officer, or trustee
    - Partner, member, or shareholder with a direct or indirect ownership interest in excess of 5% in a professional corporation or entity treated as a partnership
  - **Removed from Part IV definition** – non-stock organizations more than 35% controlled by interested persons

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Qualified Sponsorship Income

- Definition - A payment by any person engaged in a trade or business to an exempt organization without an arrangement or expectation that the payor (sponsor) will receive any substantial return benefit
- Statutorily excluded from unrelated business income under Internal Revenue Code 513(i)(1)

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Substantial Return Benefits

- Advertising
- Exclusive provider arrangements
- Goods, facilities, services or other privileges
- Exclusive or nonexclusive rights to use an intangible asset such as a trademark, logo…

De Minimis Benefits to Sponsor

- Charity may provide sponsor with benefits that have an aggregate fair market value of not more than 2% of the sponsor's payment.
- If benefits exceed the de miminis exception, the fair market value of all goods and services provided to the sponsor is potentially unrelated business income

Use or Acknowledgement – Not Advertising

- Use or acknowledgement of the name, logo, or product lines
- Exclusive sponsorship arrangements
- Logos/slogans that do not contain qualitative or comparative descriptions of payor's products, services, facilities or company
- A list of the payor's locations, telephone numbers, or Internet address
- Value-neutral descriptions – including displays or pictures of the payor's product-line or services (picture of a diet coke bottle)
- Display or distribution of a payor's product at a sponsored event (water bottles with the payor's/sponsor's logo)

Advertising

- Any message that contains qualitative or comparative language
- A message that has price information or indications of value
- An endorsement
- A message that contains an inducement to sell, or use the sponsor’s product or service.

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Exclusive Sponsor

- Acknowledgement that an event is sponsored by the payor
- Payor/sponsor receives no or de minimis substantial return benefit
- Not considered unrelated business income

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Exclusive Provider

- Definition – an arrangement that limits the sale, distribution, availability, or use of competing products, services or facilities in exchange for consideration
- Example – Co. A agrees to provide charity $XXX for the next five years if charity will only allow the sale of Co. A's products in its vending machines, snack bars and sporting events. Charity agrees to keep competitors' products off of its campus.
- Such arrangements are not qualified sponsorship payments and whether or not the payments are unrelated business income must be analyzed based on the other rules for unrelated business income

Advisory Committee on Tax-Exempt and Government Entities (ACT) – Report of Recommendations

- Open a regulation project to formalize the commensurate test so that profits from a substantial commercial activity will not preclude exemption under IRC §501(c)(3) as long as income and financial resources are used commensurate in scope with charitable programs
- Provide formal guidance on allocation of indirect costs between exempt activities and unrelated businesses
- Issue a comprehensive revenue ruling on a range of UBI issues including categorizing activities as UBI and addressing facility rentals and dual-use property
- Formalize and adopt a new web-based Form 990-T
- Continue to improve public assess to IRS materials and information through electronic database and web based resources

Key Areas of Focus – ACT Recommendations

- Facility rental/dual use property
- Cell tower rentals
- Hotel rentals and dormitory use
- Catering/food services
- Exclusive provider arrangements
- Website publications
- Bookstore operations
- Youth camps
- Technology transfer
- Guidance on preparatory time spent on activities
- Foreign blocker corporations

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Accountable Care Act Filings

- Information reporting begins in 2015 for applicable large employers (“ALE”s) and self insured employers
- ALE – generally defined as an employer with 50 or more full time equivalents in the prior year
- Form 1094-C – Transmittal of Employer-Provided Health Insurance and Coverage
- Form 1095-C – Employer-Provided Health Insurance Offer and Coverage

Transition Relief

- ALEs with fewer than 100 full-time equivalent employees will not be assessed an employer shared responsibility payment for 2015 provided certain conditions are met with regard to employer's maintenance of workforce and pre-existing health coverage. Must provide certification of eligibility with information reporting
- ALES are not required to offer cover to full-time employees' dependents for the 2015 plan year, provided certain conditions are met, including taking steps to arrange for such coverage to begin in the 2016 plan year
- Generally, Ii an ALE does not offer minimum essential coverage to at least 95% of its full-time employees, it may owe an employer shared responsibility payment based on its total number of full-time employees. For 2015, 70% is substituted for 95%.

Transition Relief

- If an ALE is subject to the employer shared responsibility payment because it does not offer minimum essential coverage to its full-time employees and their dependents, the annual payment is generally $2,000 for each full-time employee after excluding the first 30 full-time employees. For 2015, the penalty is calculated by reducing the total by 80, rather than 30
- For 2015, an ALE may base its number of full-time employees on any consecutive six-month period during 2014 rather than for the twelve months of 2014

Camp Proposal – Submitted December 2014

- Imposes a 25% excise tax on a organization on compensation in excess of $1 million paid to any of the organization's five highest paid employees
- For research institutions, all information must be made freely available to the public or the income would be considered UBI and subject to tax
- Royalties and income earned from the sale or licensing of the organization's name or logo would be UBTI
- Each UBI activity would be looked at separately. Net UBIT would be calculated on each activity. Losses from one activity could not offset gains from another activity. UBIT would be paid on an activity by activity basis
- Sponsorship payments would be treated as UBTI if the sponsor acknowledgement refers to the sponsor's product lines
- For organizations that receive more than $25,000 of qualified sponsorship payments for an event, a sponsor's payment are UBTI unless sponsor's name or logo only appears with, and in same manner as at least two donors to the event

Contact Information

Lori Burghauser
Principal
lburghauser@scandh.com

Paula Raynor
Manager
praynor@scandh.com

Visit: www.scandh.com
Phone: (800) 921-8490
Email: sch_group@scandh.com

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