

THE NONPROFIT EDGE

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- Human resources assistance

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Mission Creep: Is Your Organization Doing What It Said It Would?

By Laurie Hensley, CPA

In order to be recognized as a tax-exempt organization, most entities need to apply for exempt status with the IRS. Part of the application for exempt status is to explain to the IRS what the purpose of the organization is and how the organization intends to carry out this mission. Upon approval, the IRS issues a determination letter indicating how the entity will be categorized for tax purposes.

The IRS approval of exempt status is based on and applies only to the exempt purpose laid out in the application. Gradually the original objectives of a nonprofit can broaden beyond what was originally envisioned. This is often referred to as “mission creep,” as the mission of the organization steers away from the original intention.

Nonprofit boards should be familiar with the organization’s original exempt purpose approved by the IRS and described in the articles of incorporation or articles of association. This will enable the board to be alert to changes in the organization’s mission and focus. If the board plans to officially change its activities, it will need to change its mission statement and let all interested parties know what the board has decided to do and how they will go about making that change. Interested parties include donors, the IRS, and the state government.

Any new significant program services or changes in how program services are conducted must be reported to the IRS. If the change extends beyond the scope of a nonprofit’s articles of incorporation, the articles may need to be amended and filed with the state.

Here is an example of mission creep:

A local animal shelter applied for and received its exempt status under 501(c)3 as a charitable organization. As the years pass, the shelter grows and the board starts to look for other sources of revenue. They decide to do two things: rent out their conference room to a local school for meeting space

after hours, and start a dog grooming service on the day each week the shelter is closed.

Renting the conference room to a school may be considered tax exempt, but it was not considered in the original application and should be disclosed to the IRS. Additionally, there could be unrelated business taxable income considerations.

The grooming business will not be considered a tax-exempt activity. Even though the revenue will be used to support to shelter activities, the source of the revenue is not a tax-exempt activity. The grooming business will be an unrelated activity and as such must be reported on Form 990-T and, depending on the state involved, could be subject to state income tax.



Additionally, the board should consult a professional on whether either of these activities could be subject to state sales tax collection. Sales tax, while collected by the organization, is really paid by the ultimate purchaser—exemption from income tax does not exempt sales taxable transactions from tax.

Tax issues for tax-exempt entities can be complex due to the many types of exempt status, activities, and varying state rules. If you work with a nonprofit that has evolved over the years, check in with your tax adviser to ensure the organization is in compliance.

The Impact of the Tax Cuts and Jobs Act on Tax-Exempt Organizations

By Christina Larkin, CPA and Chris Mott, CPA

There has been a lot of coverage about the impact of the Tax Cuts and Jobs Act (TCJA) on individuals and business, so you may wonder if there are any provisions that impact nonprofit organizations. There are several provisions that include the treatment of unrelated business income, executive compensation, and investment income of private colleges and universities. The following is a summary of the old and new law as it relates to these areas:

Unrelated Business Income

Under prior law, an exempt organization that carries on more than one unrelated trade or business could calculate its unrelated business taxable income on an aggregate basis, which allowed the organization to use a deduction generated by one trade or business to offset income earned by another.

The TCJA requires that organizations that carry on more than one unrelated trade or business separately calculate unrelated business taxable income for each trade or business, effectively prohibiting using deductions relating to one trade or business to offset income from a separate trade or business.

In addition, under prior law, amounts used to provide certain fringe benefits (transportation benefits, qualified parking benefits, and access to onsite athletic facilities) to an exempt organization employee are not treated as unrelated business taxable income.

The TCJA requires exempt organizations to include in unrelated business taxable income the amount of certain fringe benefit expenses for which a deduction is disallowed.

Excise Tax on Tax-Exempt Organization Executive Compensation

Under prior law, an exempt organization was generally not subject to the limitations on the deductibility of compensation paid to organization executives applicable to non-exempt employers, and it was not subject to tax on amounts paid to such employees.

The TCJA would impose an excise tax equal to corporate tax rate (set at 21% by the TCJA) on compensation in excess of \$1 million paid to an applicable tax-exempt organization's five highest-paid employees for a tax year (or any person who was such an employee in any tax year beginning after 2016). The excise tax would also apply to parachute payments exceeding the portion of the base amount (defined as the average annual compensation of the employee for the five tax years before the employee's separation from employment) that is allocated to the payment. The tax on excess parachute payments applies only to payments made to employees who are highly compensated (within the meaning of the tax law).

Remuneration paid to licensed medical professionals in exchange for medical services performed is exempt from the definition of "compensation" for purposes of the tax.

Excise Tax on Investment Income of Private Colleges and Universities

Under prior law, an exempt private educational institution was generally treated as a public charity and was therefore not subject to the excise tax on net investment income that was applicable to private foundations.

The Tax Cuts and Jobs Act imposes a 1.4% excise tax on certain private colleges and universities and their related organizations. This provision would apply only to private institutions that have more than 500 students, have at least 50% of their students located in the United States, and have assets of at least \$500,000 per full-time student (not including assets used directly by the institution in carrying out the institution's educational purpose). The assets and net investment income of related organizations would be treated as the assets of the private college or university.

To learn more about how the Tax Cuts and Jobs Act may impact your organization, please contact us.



Five Tips for Dynamic Strategic Planning

Is your nonprofit the same organization it was three years ago? Are your stakeholders the same? What about your community and its support of your nonprofit? Change is a key reason why your nonprofit needs to revisit and revise its strategic plan regularly. You can make your strategic planning process as dynamic as change itself, but it takes focus and commitment. Here are five tips to help you ignite the strategic planning process:

1. Don't wait too long. Three years is about the right length of time between strategic plans for most organizations. The goals and objectives you developed three years ago may still be on target, but it's more likely they aren't. Almost all nonprofit organizations have struggled in recent years. Generally, funding and individual donations are down, staffs are smaller, and leadership changes have been common. Now may be the perfect time to reevaluate your organization's future and plot the route to get there. Strategic planning might be just the spark your nonprofit needs to revitalize.

2. Leave the routine behind. Because strategic planning is about a mission, a vision, and big-picture goals and objectives, the process works best when people brainstorm in a fresh setting. This requires the strategic planning team to get out of the office and temporarily put aside daily operations. The core of most strategic plans can be formed over two or three days. So have designated staff members take care of what can't wait. The rest of the work can sit until the employees on the strategic planning team return to the office. You can also consider holding your retreat over the weekend.

3. Hire an outside facilitator. Your nonprofit's executive director will take a lead role during the strategic planning sessions, but the objectivity of an outsider is valuable when working with a planning team of board members, clients, staff, and management. A facilitator can create the sense that all ideas are good ideas and keep the group on track. Team members may be more willing to speak candidly and throw away "the way we've always done things" at the urging of an outside professional with no vested interest in the organization. Also, an experienced facilitator will be at ease using methods that stimulate thinking, such as the "scenario approach," in which strategies are tested against possible external and internal events.



4. Do the prep work. You and your staff should put together a collection of documents that tell the story of your nonprofit, its current situation, and anything strongly related to its purpose, for example, demographic trend information and the results of a membership survey (if applicable). You also should have a narrative description of your organization, including its history, values, mission, programs, leadership, staff, and financial status. Many organizations also include a SWOT analysis, a detailed description of the not-for-profit's strengths, weaknesses, opportunities, and threats. Some nonprofits take the process a step further with a PEST analysis, which looks at the political, environmental, social, and technical factors affecting the organization.

5. Make the big decisions. The strategic planning sessions should focus on the big picture as you review your nonprofit's mission statement and create a clear and concise vision statement of what your organization will look like at a specific point in the future. Then you'll want to discuss and draft your nonprofit's goals (not more than two or three), objectives that need to be met to achieve each goal, and strategies for reaching the objectives. As a follow-up to the sessions, the strategic planning team should form an action plan with a timeline and assigned responsibilities. The action plan will be the implementation boilerplate after the strategic plan is approved by the board of directors.

The uniqueness of your organization will dictate the shape, complexity and, of course, the content of your strategic plan. The challenge after strategic planning is to implement the plan in a timely manner and to review it along the way for major changes that must be taken into account.

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Charitable Organizations May Have to Register in Multiple States When Receiving Contributions

By Svetlana Svetlichnaya, CPA

Most U.S. states require charitable nonprofits that are soliciting contributions to submit an initial registration and to follow up with an annual renewal registration. These state law requirements are known as charitable solicitation regulations.

In most states, the regulations require nonprofits to register in the state before the nonprofit solicits any resident of the state. The forms and registration requirements vary from state to state. Forty-one jurisdictions have registration requirements that are triggered by solicitation. Some of these states may have a minimum threshold that must be met in order to meet a registration requirement. Other states may require disclosure statements to be included on solicitation materials.

In an attempt to unify and simplify the registration process, the National Association of Attorneys General and the National Charities Officials created the Unified Registration Statement (URS). However, the number of states willing to accept this form instead of their individual state form has steadily decreased.

Many states change their rules frequently, and the URS has not stayed up to date. The URS form therefore now contains errors that result in rejected registration applications. And despite what some online sources say, many states no longer accept the URS.

Registration requirements are less clear when a charity does not target a specific audience located in another state but maintains a website that invites or accepts contributions through a “donate now” button on its website. Many states have not updated the definition of solicitation in their laws to clarify if a charity maintaining a website with a donate option requires registration with the state.

The general rule states that if an organization receives contributions from the state on a repeated and ongoing basis or a substantial basis through its website, they most likely have a registration requirement.

These registration requirements are designed to protect donors from illegitimate organizations and fraudulent solicitation of funds for non-charitable causes. States can penalize for unlicensed solicitation, which can include fines, late fees and other penalties, denial of the right to solicit funds, negative publicity, damaged relationships with donors and grant makers, or lost donations or grants.