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Will Your Parking Expenses Generate UBTI?

By Svetlana Svetlichnaya, CPA

In late 2017, the Tax Cuts and Jobs Acts (TCJA) created the most significant overhaul of the tax system in over 30 years. Throughout 2018, the IRS had been issuing notices to clarify the new law and its effects on taxpayers. The IRS issued notice 2018-99 regarding parking expenses for Qualified Transportation Fringes under Section 274(a)(4) and Section 512(a)(7) of the Internal Revenue Code. These sections disallow deductions for expenses with respect to qualified transportation fringes provided to employees of for-profit organizations and tax-exempt organizations must increase unrelated business taxable income (UBTI) by the amount of the qualified transportation fringes expense that are nondeductible.

The TCJA disallows deductions for the expenses of qualified transportation fringe (QTF) benefits that are provided by employers for their employees. QTFs are defined to include: (1) transportation in a commuter highway vehicle between the employee's residence and place of employment, (2) any transit pass, and (3) qualified parking. Qualified parking is defined as parking provided to an employee on or near the business premises of the employer or on or near a location from which the employee commutes to work.

There are a variety of qualified parking methods employers use to provide tax-free parking benefits to employees. Employers may allow employees to park at no cost or at a reduced rate in an employer-owned or leased parking facility. Employers may pay a third party so employees can park at the third party's garage or lot. Alternatively, employers may reimburse employees for the cost of parking, or allow employees to pay for parking on a pre-tax basis through a salary reduction arrangement. Qualified parking does not include any parking on or near the property used by the employee for residential purposes.

If a taxpayer paid a third party for employees to park in the third party's garage or lot, the amount paid to the third party is a parking expense. This type of parking expense is an employee related parking expense and, therefore, is UBTI up to the statutory limit for exclusion from employee wages, which was $265 per employee in 2019. Amounts above the exclusion maximum are not UBTI and must be properly included in employee wages.

If a taxpayer owns or leases a parking facility, parking expenses include but are not limited to repairs, maintenance, utility costs, insurance, property taxes, interest, snow and ice removal, leaf removal, trash removal, cleaning, landscape costs, parking lot attendant expenses, security, and rent or lease payments or a portion of a rent or lease payment if not broken out separately. Depreciation on a parking structure is not considered a parking expense for this purpose. These parking expenses are only UBTI to the extent they relate to employee parking. Parking made available to the general public will not generate UBTI.

To be considered available to the general public, parking needs to be reserved for the public or needs to be unreserved and be used by the public. The notice clarifies that empty spots are considered used by the public. Parking expenses allocated to unreserved spots that are either empty or used by the public will not generate UBTI. The general public includes customers, clients, visitors, patients, students, individuals delivering goods, and congregants of a religious organization. It does not include employees or independent contractors.

The notice provided a primary use test, which is a key factor in reducing the number of exempt organizations subject to UBTI on parking expenses. Primary use is defined as greater than 50 percent of actual or estimated usage of the parking spots in the parking facility. If most of a parking facility, excluding employee-reserved spots, is used by the public, all of the unreserved spots in the facility are considered to be available to the general public. Primary use is tested during the normal hours of the exempt organization's activities on a typical day.

Parking spots reserved specifically for employees are considered employee parking, and parking expenses allocated to those spots is UBTI. The notice provided a special rule for reserved employee spots. Employee spots that were reserved but were changed to be unreserved by March 31, 2019 were unreserved retroactively going back to January 1, 2018.

Not-for-profit companies can reduce their UBTI by removing reserved parking spots for employees and expanding their space to include more spots for the general public, if necessary, to pass the primary use test.

This memo is intended as an overview of the Notice 2018-99. As with all aspects of taxation there are many exceptions and special rules to consider. Please contact us if you require additional information.

Decipher the Form 990 Sections on Compensation Reporting

Most tax-exempt organizations must file Form 990 with the IRS. This form, titled Return of Organization Exempt from Income Tax, has significant implications for not-for-profit organizations. The compensation of officers, directors, trustees, key employees and others in tax-exempt organizations has always been scrutinized by the IRS. That is why compensation reporting is so important on Form 990.

Relevant data is reported in three places:

- "Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees;"
- "Statement of Functional Expenses," lines 5, 7, 8, and 9; and
- Schedule J, "Compensation Information for Certain Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees."

In each instance, there are significant differences in the amounts and details included. As a result, properly reporting compensation is one of the more difficult tasks in preparing Form 990.

Note: Determining exactly who should be listed in Part VII, Section A and Schedule J can be complex. This article only covers some compensation reporting issues for those listed. Consult with your not-for-profit adviser to help identify the individuals who should be listed.

What Is the Period for Reporting Compensation?

The compensation reported in Part VII, Section A and in Schedule J should be for the calendar year ending with or within the organization's tax year. The amounts reported in Part IX are based on the organization's tax year. Therefore, fiscal year organizations must keep dual sets of compensation data.

What Compensation Must Be Reported?

Part VII and Schedule J both ask for the compensation reported on an employee's Form W-2, box 1 or 5 (whichever is greater), and an independent contractor's (i.e., director or trustee) Form 1099-MISC, box 7. This "reportable compensation" is shown by its source -- the filing organization or a related organization. (The IRS definition of a "related organization" is in the right-hand box.)

Schedule J further requires that reportable compensation be identified as base compensation, bonus/incentive compensation, or other reportable compensation. Examples of other reportable compensation included on Schedule J are current year payments earned in a prior year, severance payments, and longevity of service awards.

What about Retirement and Deferred Compensation?

Schedule J (but not Part VII) requires that all types of deferred compensation be reported in a separate column. This includes deferrals under both qualified and nonqualified retirement plans maintained by the filing organization or by a related organization, and the annual increase or decrease in actuarial value of a defined benefit plan (but not the earnings or losses accrued on deferred amounts in a defined contribution plan). Deferred compensation may be funded or unfunded, vested or subject to a substantial risk of forfeiture.

If a deferred comp arrangement requires an employee to perform services for a period of time, the amount is treated as accrued or earned ratably over the service period, even though the amount is not funded and may be subject to a substantial risk of forfeiture until the end of the service period.

Compensation paid within 2 1/2 months after the end of the tax year is treated as current compensation rather than deferred compensation.

Which Benefits Are Not Taxable?

Benefits specifically excluded from tax under the Internal Revenue Code must be reported on Schedule J. However, to make matters more confusing, certain benefits are considered disregarded under IRC Section 132 and are not reported.

Disregarded Benefits. Common disregarded benefits include reimbursements pursuant to an accountable plan, no-additional cost services, qualified employee discounts, de minimis benefits, and working condition benefits.

An accountable plan is a reimbursement or other expense allowance arrangement that satisfies these three requirements:

The expenses covered under the plan must be reasonable employee business expenses.
The employee must adequately account to the employer for the expenses within a reasonable period of time.
The employee must return any excess amount within a reasonable period of time.
A de minimis fringe is a property or service of which the value (taking into account the frequency with which similar fringes are provided by the employer) is so small as to make accounting for it unreasonable or administratively impractical.

A working condition fringe is any property or service provided to an employee to the extent that if the employee paid for it, the payment would be a deductible business expense. Common examples of a working condition fringe benefit are:

1. The value of an employee's business use of an employer-provided automobile; and

2. The business use of a cell phone provided for an employee primarily for business purposes. (The personal use of such cell phone is considered a *de minimis* fringe.)

Directors and trustees are treated as employees for purposes of the working condition fringe provisions.

What Are Reportable Nontaxable Benefits?

The following are examples of benefits that should be reported as nontaxable benefits in column D of Schedule J (unless they are reported as taxable compensation):

- Most types of insurance, including health, life, disability, medical reimbursement programs, long-term care, and job-related liability insurance.
- Various types of assistance payments, such as for dependent care, adoption, tuition, and other items.

The value of housing provided by the employer to an employee may be:

- Taxable (for example, a cash housing allowance);
- A nontaxable working condition fringe, statutorily nontaxable (for example, housing provided primarily for the convenience of the employer); or
- Partly taxable and partly excluded from tax (for example, the value of in-kind housing provided to certain school employees).

Reporting Exceptions

There are some compensation reporting exceptions for Part VII and Schedule J:

The $10,000 Exception. Reportable compensation from related organizations [Part VII, Section A, column (E)] generally doesn't include payments from a single related organization if such payments are less than $10,000 for the calendar year ending with or within the organization's taxable year. However, there is no de minimis exception for payments to a former director or former trustee.

Note: This exception doesn't apply to Schedule J reporting.

The Volunteer Exception. An organization isn't required to report in column (E) or (F) of Part VII, Section A, compensation paid to a volunteer trustee, director, or officer of the filing organization if the related organization is a for-profit entity, is not owned or controlled directly or indirectly by the filing organization or one or more related tax-exempt organizations, and doesn't provide management services for a fee to the organization.

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Debt Isn't a Bad Word: Why Your Organization Might Want to Borrow

Debt is an integral part of the strategic plans of many organizations, yet it has traditionally carried a stigma in the not-for-profit industry. That view is changing, as more organizations borrow money for major capital purchases, new program funding — even to manage current cash flow.

But if you're hoping to borrow funds, know that not all not-for-profits qualify. And even if you're able to find a lender, it takes prudent financial management and reliable donor support to pay back a loan.

Exhaust Other Options First. You may think your organization has a good rationale for borrowing, but that doesn't mean lenders — or even your supporters — will agree. One of the primary criteria watchdog groups such as Charity Navigator and Charity Watch use to evaluate not-for-profit organizations is the percentage of available funds spent on programs. If a large portion of your budget is tied up in debt repayment, that's likely to be affect how the public, including prospective donors, perceives your organization.

What's more, lender covenants may prevent you from borrowing for other purposes -- and thus limit strategic flexibility -- until your existing debt is paid off. And as many not-for-profits have learned in recent years, debt makes periods of economic uncertainty that much more challenging. So in general, it's best to exhaust other funding sources, such as public and private grants and major donations, before applying for a loan.

Are You Prepared? Even if you determine your not-for-profit can handle the risks of borrowing, you likely won't qualify for a loan unless you have all your ducks in a row. Before approaching a lender, make sure you have:

- A realistic repayment plan that doesn't strain your operating budget;
- Current financial statements, recent tax returns and up-to-date cash-flow projections;
- Collateral to secure the loan, such as your not-for-profit's accounts receivable, unencumbered real estate or equipment;
- A proven history of prudent financial management; and
- The support of your board of directors.

The odds of qualifying for a loan are better if you've already established relationships with lenders — preferably those with experience lending to not-for-profit organizations. You may even want to establish a small line of credit with a local bank at a time you don't actually need the money. That way, the bank will know you when you apply for a larger loan.

Be sure to ask for assistance from board members who may work in banking or who can introduce you to lenders they know.

Justify Your Loan. Lenders want to know, in detail, why your not-for-profit is seeking funds and what you hope to achieve with them.

One of the most common reasons organizations seek loans is to make major purchases. For example, a private secondary school may want to replace its aging gym with a new athletic facility. Or a senior community center may need a specially equipped van to transport disabled clients. Generally, such purchases are partially funded by grants or donations — and evidence of such support is likely to help your application.

Many not-for-profit organizations also borrow to stabilize cash flow — typically with a line of credit. You may, for example, need funds to bridge billing and collections gaps or to remain liquid while waiting for a major grant check to arrive. Such credit is usually acceptable as long as you don't routinely borrow the maximum amount or continually operate your organization with a deficit.

It may be harder to justify a loan to fund new programs or initiatives — unless you can prove that they are essential to your mission and that they are likely to produce income down the line. And while you may be able to borrow to address an emergency situation, don't get into the habit of calling a loan officer every time the unexpected happens. That's what emergency savings and contingency plans are for.

Reasonable Certainty - As many consumers have learned the hard way, it's easy to dig a hole for yourself with debt. But a loan might be right for you if you know with reasonable certainty how your organization will repay it and you've determined with your board and financial advisors that the possible negative consequences of debt financing are remote.

Form 990

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Other Compensation - Part VII

Don't be confused by a similar term -- "other reportable compensation" in Part II, column (B)(iii) of Schedule J, discussed previously, is not the same as "other compensation" used in column (F) in Part VII, Section A. Here, other compensation includes deferred compensation and nontaxable benefits, as discussed previously with respect to Schedule J reporting.

Recommendation: Your organization should consider its compensation recordkeeping with these requirements in mind to determine the best way to capture the necessary information.

Our Partners:

David Iles, CPA, Managing Partner
Linda Bruckner, CPA
Renata Dabrowska, CPA
Jeff Gorsky, CPA
Amy Iles, CPA
David Stinson, CPA, MS

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Sciarabba Walker & Co., LLP
410 E Upland Road
Ithaca, NY 14850

RETURN SERVICE REQUESTED

A Guide to Grant Revenue Accounting

By Dylan Wright, CPA

Many not-for-profit entities derive a large amount of their revenue from grants. Therefore, it is important for these entities to be familiar with the accounting and recognition of revenue associated with grants.

The release of the new revenue standard, ASU 2014-09 Revenue from Contracts with Customers, ASC Topic 606 in May of 2014 left many uncertainties regarding the recognition of grant revenue. However, the release of ASU 2018-08 Clarifying the Scope of the Accounting Guidance for Contributions Received and Contributions Made, cleared up many said uncertainties. The release of ASU 2018-08 provided steps to take in order to properly recognize grant revenue.

One of the first important steps for a not-for-profit company to take when recognizing grant revenue is to be able to distinguish between a reciprocal transaction and a nonreciprocal transaction. For a transaction to be considered reciprocal, the recipient must provide direct commensurate value to the provider of the resource or a specified third party. If a transaction is reciprocal and there is an exchange of commensurate value, ASU 2014-09 should be followed. If no commensurate value is exchanged, then the transaction should follow the ASC 985-605 rules for contributions. These rules are typically used for grant revenue recognition, since grants usually do not have an exchange of commensurate value.

If after step one you decide the transaction is nonreciprocal, you need to identify whether the grant is conditional or unconditional. The new ASU added additional information to clarify what makes a grant conditional. The ASU states that, “a grant is conditional if the recipient must overcome a barrier to be entitled to the resources provided by the grant and the grantor is released from its obligation to transfer resources if the recipient fails to overcome the barrier.” If neither of these conditions are present, the grant is considered unconditional and revenue should be recognized when received. If both conditions are present, the grant is considered conditional and the revenue should not be recognized until the respective conditions are met.

Lastly, it is important to record the grant revenue correctly based on whether it is restricted or unrestricted. If there are donor-imposed restrictions present for the grant, the recipient should report the revenue as an increase in net assets with donor restrictions. A few examples of restrictions could be timing or purpose requirements. If there are no donor-imposed restrictions, the grant should be reported as revenue as an increase in net assets without donor restrictions.

This new standard should be implemented for not-for-profit entities’ annual reporting periods beginning after December 15, 2018. Not all grant revenue recognition will be straightforward. When analyzing certain grants, any of the steps mentioned above may be difficult to perform.

If you require additional information, or need help implementing the new revenue recognition standard, please contact us.