BDO

FROM THE BLOG OF THE BDO NONPROFIT & EDUCATION PRACTICE – SPECIAL EDITION

NONPROFIT STANDARD

11 RISKS HIDDEN IN YOUR FORM 990

By Rebekuh Eley, CPA, MST

As watchdog groups and other stakeholders continue to expect increased transparency from nonprofits, it's become all the more important for organizations to prepare Form 990 as accurately and completely as possible.

These publicly available forms can expose organizations to public scrutiny, but they can also leave the door open for preventable penalties from the IRS and state and local taxing authorities. Read the list below to learn about some of the hidden pitfalls in your Form 990 that you may never have noticed, but need to address.

1. **You have a history of reporting gross income and net losses from activities that are not substantially related to your mission** (Part I, Questions 7a and 7b)
   You will need to ensure that the activities you've reported as unrelated business income meet the criteria and methods for allocating costs between related and unrelated activities. The IRS is paying close attention to this, and is focused on monitoring nonprofits' methods of allocating costs and determining whether their activities would qualify as businesses with a profit motive. If organizations don't take care, an audit could mean they face significant retroactive tax burdens.

2. **Your organization has a financial interest over a foreign account** (Part V, Question 4)
   If you're engaged in foreign activity or have signature authority over a foreign bank account or other type of foreign financial account (exceeding certain thresholds), then you may need to file Form 114, Report of Foreign Bank and Financial Accounts (FBAR). The rules relating to this filing are very complex, and the penalties for noncompliance are steep—$10,000 for each non-willful violation and $100,000 (or 50 percent of the account's highest balance, whichever is greater) for failure to file an FBAR.

3. **Your organization has a significant amount invested with alternative investments** (Part X, Question 12 and Schedule D, Part VII)
   If you have investments such as managed futures, hedge funds, commodities or derivatives contracts, you may be exposed to unrelated business income, foreign filing and state filing obligations. The rules in each of these areas are very complex and can lead to steep penalties for noncompliance. You should also ensure you are compliant with the U.S. Foreign Investment Disclosure Rules (USFID) and the U.S. Foreign Account Tax Compliance Act (FATCA), as those penalties are more severe than the penalties for failure to file a Form 990 or 990-T.

4. **Some of your employees receive compensation packages greater than $150,000** (Schedule J)
   Your organization could face potential unreported compensation issues or compliance risks if employees with salaries greater than $150,000 receive fringe benefits and expense reimbursements without a written policy, or participate in a nonqualified retirement plan. To reduce your risk, you may consider establishing an accountable reimbursement plan and using an independent compensation consultant or commissioning a compensation survey or study to support your organization's compensation decisions.

Want to hear what's going on in the Nonprofit industry?

Keep up with industry hot topics by following us on Twitter **@ BDONonprofit**

Subscribe to our blog **nonprofitblog.bdo.com**

To learn more about how BDO's Nonprofit & Education practice can help you manage risk please contact:

Laurie De Armond
Nonprofit & Education Practice Leader
703-336-7453
ldearmond@bdo.com

Read more ▶

5. **Your organization has a significant amount of inventory sales** (Part VIII, Question 10)
   If this is true, or if you store inventory in a warehouse in a different state, you may be exposed to sales tax and other regulation under state taxing authorities. Although nonprofits are exempt from income tax, they are not exempt from sales tax or sales tax collection responsibilities.

6. **You have offices, employees and/or independent contractors in a foreign country** (Schedule F)
   You may have created a taxable presence in a foreign country. A U.S. tax exemption does not mean an organization is exempt from tax elsewhere. You'll need to determine whether foreign income tax or Value Added Tax (VAT) reporting requirements exist and whether your organization is in compliance with those requirements. You'll also need to assess whether further action is necessary to avoid establishing an unintended taxable presence in a country.

   This type of foreign activity may also trigger employment tax reporting and withholding requirements, not only in the U.S. but also the foreign country. Employees, too, may face individual tax reporting requirements in foreign countries where they are working. You should carefully review these work-abroad arrangements for compliance and to ensure your employees are aware of their non-U.S. filing requirements.

7. **Your organization has established foreign subsidiaries** (Schedule F)
   Compliance in this area requires knowledge of the tax laws, regulations and other requirements for the countries in which you do business. For any foreign entity, you will also need to ensure that U.S. international tax compliance reporting is included with your Form 990 or 990-T. If you fail to file the additional forms, your organization may face significant penalties – typically $10,000 per form missed per year.

8. **You have outstanding liabilities associated with tax-exempt bond issues** (Schedule K)
   Your organization could easily become noncompliant if it is not vigilant regarding the rules related to spending bond proceeds and the use of bond-financed property. Good post-issuance compliance is critical in order to maintain the tax-exempt status of the bonds. The rules must be met for as long as the bonds are outstanding.

9. **You have more 1099s than Forms W-2** (Part V, Questions 1 and 2)
   If this is true, or if you've disclosed compensation for your organization's employees under Part VII but did not disclose forms W-2, you could be improperly classifying workers as independent contractors or employees. Failure to classify workers properly can not only lead to penalties; it can also subject your organization to audits from Federal and state tax authorities, the Department of Labor and other regulatory agencies, especially if a misclassified worker quits and files for unemployment benefit.

10. **You believe or indicate that you've followed the correct process for determining executive compensation** (Part VI, Question 15)
    The IRS rules for determining whether an executive's compensation is reasonable and not excessive sound simple: approve the arrangement in advance by an authorized body, obtain and rely on comparable data, and document the basis for the determination. While you may believe you're following these rules to the letter, you may need to adapt your policies to establish the Rebuttable Presumption of Reasonableness that shifts the burden to the IRS to prove that compensation is not reasonable. Many organizations check the "yes" boxes indicating they've followed the right process, but may not take all the steps to ensure compliance, including:

    - Adding a compensation study to comply with the comparability component; and
    - Documenting compensation committee meeting minutes that satisfy IRS requirements, with adequate detail—who participated in the meeting, what was discussed, what competitive data was relied upon and the results of any vote or decisions made.
    - Failure to fully comply leaves the board and those who can influence the organization at risk of potential intermediate sanctions.

11. **You have a taxable, related organization in which you do business** (Schedule R)
    There are special tax rules for exempt organizations that have taxable subsidiaries. Income from the taxable subsidiary to the parent exempt organization that would otherwise not be taxable may become taxable. You need to take precautions to maintain separation so the taxable subsidiary does not threaten your tax exemption with significant unrelated business activities through an agency relationship. Your organization should also have a transfer pricing study to substantiate any charges and reduce your exposure to penalties.

BDO NONPROFIT & EDUCATION PRACTICE

For more than 100 years, BDO has provided services to the nonprofit community. Through decades of working in this sector, we have developed a significant capability and fluency in the general and specific business issues that may face these organizations.

With more than 2,800 clients in the nonprofit sector, BDO's team of professionals offers the hands-on experience and technical skill to serve the distinctive needs of our nonprofit clients—and help them fulfill their missions. We supplement our technical approach by analyzing and advising our clients on the many elements of running a successful nonprofit organization.

In addition, BDO's Institute for Nonprofit Excellence[SM] (the Institute) has the skills and knowledge to provide high quality services and address the needs of the nation's nonprofit sector. Based in our Greater Washington, DC Metro office, the Institute supports and collaborates with the nonprofit community at large, BDO offices around the country and the BDO International network to develop innovative and practical accounting and operational strategies for the tax-exempt organizations they serve. The Institute also serves as a resource, studying and disseminating information pertaining to nonprofit accounting and business management.

The Institute offers both live and local seminars, as well as webinars, on a variety of topics of interest to nonprofit organizations and educational institutions. Please check BDO's web site at www.bdo.com for upcoming local events and webinars.

ABOUT BDO USA

BDO is the brand name for BDO USA, LLP, a U.S. professional services firm providing assurance, tax, advisory and consulting services to a wide range of publicly traded and privately held companies. For more than 100 years, BDO has provided quality service through the active involvement of experienced and committed professionals. The firm serves clients through 63 offices and more than 450 independent alliance firm locations nationwide. As an independent Member Firm of BDO International Limited, BDO serves multi-national clients through a global network of 1,408 offices in 154 countries.

BDO USA, LLP, a Delaware limited liability partnership, is the U.S. member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms. BDO is the brand name for the BDO network and for each of the BDO Member Firms. For more information please visit: www.bdo.com.

Material discussed is meant to provide general information and should not be acted on without professional advice tailored to your firm's individual needs. © 2016 BDO USA, LLP. All rights reserved.