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2020 Year-End Planning for Not-for-Profits

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2020 Year-End Planning for Not-for-Profits

We hope this letter finds you healthy and safe during this unprecedented time. As your organization continues to operate, consider some of the regulatory changes affecting not-for-profit organizations.

Donor Acknowledgement Letters

Please remember to send a contemporaneous written donor acknowledgment letter to all donors who contributed to the organization during the tax year. The IRS has disallowed charitable contribution deductions when the donor does not have the contemporaneous donor acknowledgment letter required by IRC §170 or when the letter fails to include the required information, [including the quid pro quo language](#).

Estimated Tax Payments

As a reminder, organizations with unrelated business income must make tax payments throughout the year or be subject to underpayment penalties. At a minimum, organizations should make estimated tax payments equal to the previous year's tax liability. However, organizations whose unrelated business taxable income is \$1M or more in the prior year are generally required to make estimated tax payments based upon the annualization periods and due dates below:

Estimated Payments	Income Through	Due Date
1 st Installment	2 months	15 th day of 5 th month
2 nd Installment	3 months	15 th day of 6 th month
3 rd Installment	6 months	15 th day of 9 th month
4 th Installment	9 months	15 th day of 12 th month

Any federal tax payments must be made to the IRS using either a wire transfer or the [Electronic Federal Tax Payment System](#) (EFTPS).



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Financial Statement Updates:

If your organization is required to follow generally accepted accounting principles (GAAP), some changes to the standards will be issued soon, some will be implemented this year, and others have been deferred.

Deferred Guidance

In response to the coronavirus (COVID-19) pandemic, which is causing significant disruption both within the United States and globally, the FASB issued an accounting standards update (ASU) 2020-05, *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842)*. ASU 2020-05 provides limited deferral of the effective dates of ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)* and ASU 2016-02, *Leases (Topic 842)*, both described below.

Note that deferrals apply only to certain entities. “Public not-for-profit entities” are not-for-profits that have issued, or are conduit bond obligors for, securities that are traded, listed, or quoted on an exchange or over-the-counter market. We often see this situation with not-for-profits that have issued tax exempt bonds. Most other not-for-profits are considered “private not-for-profits” and fall within the “all other” category.

Revenue Recognition for Revenue from Exchange Transactions

ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)* impacts commercial and not-for-profit organizations as well as updates and clarifies the principles for when and how to recognize revenue from exchange transactions, or “earned revenue.” Not-for-profit organizations that have revenue from exchange transactions should review this standard to determine if any changes are necessary for accounting for such revenues.

Implementation may be deferred one year for certain entities that have not yet issued their financial statements (or made them available to be issued). Those entities may defer implementation to years beginning after December 15, 2019. Public business entities, public not-for-profit entities (as defined above), and employee benefit plans that file or furnish financial statements to the SEC are not affected, as they would have implemented Topic 606 based on the pre-update effective date of periods beginning after December 31, 2017. Early adoption is still permitted.

Accounting for Contributions Received and Contributions Made

During 2018, the FASB issued ASU 2018-08 *Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made*. This new standard updates and clarifies the guidance for transactions that use the contribution accounting model, which broadly includes all nonreciprocal transactions such as donations from individuals, grants from foundations, and most governmental awards. It also applies to both contribution revenue and contribution expense.

The guidance in ASU 2018-08 addresses two key accounting issues: 1) how to differentiate a nonreciprocal transaction (contribution) from an exchange transaction (earned revenue), and 2) how to identify whether a contribution contains a condition. ASU 2018-08 is effective for most organizations for years beginning after December 15, 2018, for contributions received and for years beginning after December 15, 2019, for contributions made. Note that the FASB did not provide deferred effective dates for ASU 2018-08.

Leases

The FASB issued ASU 2016-02, *Leases (Topic 842)* to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheets of lessees and disclosing essential information about leasing transactions. This update will generally apply to all leases, except those with terms of 12 months or less. Not-for-profits that carry conduit debt, such as tax-exempt bonds issued by a governmental agency, must implement the standard earlier if those bonds are publicly traded. Although implementing this new standard is not yet required for most organizations, you should understand the impacts on your balance sheet and possible effects on any bank covenants well before the implementation date. Gathering and organizing the information for all your leases, including capital leases, operating leases, leases of easements, and other types embedded in contracts, could take some time.

Implementation may be deferred one year for entities in the “all other” category to years beginning after December 15, 2021. Public not-for-profit entities that have not yet issued their financial statements (or made them available to be issued) may elect to adopt Topic 842 for years beginning after December 15, 2019. Early adoption is still permitted.

Gifts-in-Kind

In February 2020, the FASB issued an exposure draft that would update the required financial statement presentation and disclosures for nonfinancial gifts-in-kind (GIK). The proposed updates would require contributed nonfinancial GIK to be presented as a separate line item in the financial statements. Additional disclosures would include disaggregation by type of donated asset, information about whether the assets will be monetized or utilized, a description of the programs or activities in which the GIK will be used, and information about any donor restrictions. The valuation techniques and inputs used to arrive at the fair value measurement, including the principal market or most advantageous market, will also be required disclosures. Implementation will be applied retrospectively to all periods presented in the financial statements. The update is expected to be finalized during 2020; however, the effective date has not yet been determined.

State and Local Updates:

Washington B&O Tax Rate Increase on Service and Other Activities

Effective April 1, 2020, the Washington business and occupation (B&O) tax on service and other activities increased to 1.75% for businesses and organizations with taxable gross income subject to the service and other B&O tax classification of \$1 million or greater in the prior calendar year. For purposes of determining whether the business or organization meets this threshold, taxable gross income subject to the service and other tax classification includes the service and other taxable income of all affiliates.

An affiliate is any person that directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with another person. Businesses or organizations with taxable income below the threshold continue to be subject to the 1.5% tax rate. Hospitals, as defined under state law, are not subject to the rate increase.

Changes to City B&O Tax Apportionment

Legislative changes enacted in 2019 require cities imposing a B&O tax to modify the method taxpayers are required to use to determine the amount of service and other income reportable to the city. Since 2008, cities have been required to use a two-factor apportionment method consisting of payroll and service income. Under prior law, the service income factor was computed by assigning service receipts to the city based on a complicated and often unfair determination of “customer location.” Effective January 1, 2020, the determination of customer location has been simplified. For a customer not engaged in business, the customer location is where the service is performed if the customer is required to be present. If the customer is not required to be present, the customer location is their residence, or if not known, the billing/ mailing address. For customers engaged in business, the customer location is where the services are ordered from, or if not known, the customer’s billing/ mailing address. If neither the location from where the services are ordered or the billing/ mailing address is known, then the customer’s commercial domicile. The legislation also clarifies and broadens the circumstances when a taxpayer is considered taxable in the customer location for purposes of making a “throw-out” adjustment to the denominator of the service income factor.

B&O Taxability of Federal COVID-19 Financial Assistance

The Washington State Department of Revenue (DOR) recently published guidance regarding its view on whether federal COVID-19 related financial assistance is subject to B&O tax, including loan forgiveness under the Paycheck Protection Program. According to the guidance, the DOR indicates that it does not believe the financial assistance is includable in the measure of the B&O tax, and that taxpayers should not report such amounts. It goes on to say that if legislature clarifies taxability resulting in a different conclusion, no interest or penalties will be imposed on any retroactive application of such clarification.

Washington State Paid Family and Medical Leave Program

Beginning January 1, 2019, the State of Washington will collect premiums from both employers and employees to fund the Washington State Paid Family and Medical Leave program. This new requirement is outlined in RCW 50A.04 and does include some modifications for organizations with fewer than 50 employees. The benefit of the Act is that Washington State employees will get paid time off for the birth or adoption of a child or for serious medical conditions. Some options will need additional consideration as they might impact your organization’s leave policies. It is also possible to seek approval of a voluntary plan, rather than participate in the State program. Considering these decisions well in advance is recommended.

Washington Disclose Act of 2018

Nonprofit organizations making contributions or expenditures in Washington election campaigns may be subject to a new filing requirement with the Washington State Public Disclosure Commission (PDC). A nonprofit organization must register with the PDC as an “incidental committee” if it spends, or expects to spend, \$25,000 or more in one calendar year on ballot measure campaigns or candidates for office and receives aggregate payments of \$10,000 or more from a single source. Once registered, organizations must disclose their top ten donors above \$10,000 to the PDC, regardless of whether the donations were intended for political or lobbying purposes. More information is available on [the PDC website](#).

Organizations who are required to register with the PDC should keep in mind that there are still federal tax laws for organizations engaging in political and lobbying activities.

Federal Tax Updates:

Recent Tax Developments

The Tax Cuts and Jobs Act (December 2017) created significant changes for not-for-profit organizations. Included in this Act was the segregation and disallowance of unrelated business losses from separate trade or businesses conducted by exempt organizations with more than one activity. This is often referred to as the “unrelated business income siloing.” On April 23, 2020, proposed regulations were issued providing guidance for determining separate trade or businesses, allocating directly connected deductions, and reporting unrelated income from pass-through investments and debt-financed property.

On December 20, 2019, Congress repealed the inclusion of qualified transportation benefits as part of unrelated business taxable income for exempt organizations. Organizations that previously paid tax on these benefits should file an amended return to recover any tax associated with those benefits. If these benefits only affected the amount of a net operating loss carryforward, the IRS indicated that no amended return is required. In this case, the organization should correct the amount of net operating loss carried forward and include an explanation of the change on the next year’s tax return.

Another provision in the TCJA was the excise tax on remuneration over \$1 million and excess parachute payments. Proposed regulations were issued on June 5, 2020 clarifying who is considered an employee/covered employee of an applicable tax-exempt organization, the exceptions to the rules, and further defined what is included as remuneration.

Lastly, the TCJA also brought to the table an excise tax of 21% on the net investment income of college and university endowments. On June 28, 2019, proposed regulations were issued providing guidance on who is subject to the excise tax and what is included in net investment income.

In March 2020, Congress passed the Family First Coronavirus Response Act (FFCRA) and Coronavirus Aid, Relief, and Economic Security (CARES) Act. Both Acts provide a variety of tax provisions, [including a tax credit for FFCRA paid leave](#), [the deferral of employer payroll taxes](#), and [the employee retention credit](#).

The CARES Act also [allows for a five year carryback for net operating losses](#) generated in 2018-2020, thereby reversing the net operating loss provisions set by the Tax Cuts and Jobs Act in 2017. For more information and links to additional COVID-19 resources, visit [the Clark Nuber COVID-19 Resource Center](#).

One of the most talked about provisions of the CARES Act is the new Payroll Protection Program. Eligible organizations may receive a loan of up to 2.5 times their average monthly payroll costs that is eligible for forgiveness when used for qualified expenses. The rules are evolving and many questions remain. For the latest information, visit the [Small Business Administration website](#).

IRS Tax Exempt and Government Entities Fiscal Year 2020 Program Letter

Each year, the IRS' Tax Exempt and Government Entities (TE/GE) division releases a program letter, which outlines TE/GE's priorities for the coming fiscal year. For exempt organizations, TE/GE's compliance strategies include hospital organizations with unrelated business income, social clubs' investment and nonmember income, and organizations previously operating as for-profit entities before conversion to public charities. TE/GE also continues to use data and queries to drive its work plan, including query sets based on information reported on Forms 990 and 990-EZ. Finally, TE/GE continues to examine organizations that received exempt status through filing Form 1023-EZ, Streamlined Application for Recognition of Exemption Under Section 501(c)(3). The Program Letter is available on the [IRS website](#).

Inflation Adjustments

Over sixty tax provisions are adjusted for inflation annually. For the tax year 2020, the following inflation-adjusted amounts may apply to public charities:

- The fringe benefit exclusion for qualified transportation benefits is \$270/month (\$265/month in 2019). The threshold applies separately to parking benefits and mass transit benefits.
- Insubstantial benefit limitations for contributions associated with fundraising campaigns:
 - The low-cost article threshold is \$11.20 (\$11.10 in 2019).
 - Contributions of \$56 or more (\$55.50 in 2019) are fully deductible to donors if only "token items" are provided in exchange for the contribution. Token items are identified based on the cost to produce. In 2020, organizations may use the low-cost article threshold of \$11.20 (\$11.10 in 2019).
 - Contributions are fully deductible to donors if the fair market value of all benefits provided in exchange for a contribution is \$112 (\$111 in 2019) or 2% of the payment, whichever is less.
- The reporting exception for nondeductible lobbying expenditures concerning dues received from a person, family, or entity is \$119 or less (\$117 in 2019).

Donor Disclosure to IRS

Starting with calendar year 2018 Form 990 filings, organizations exempt under a Code Section other than 501(c)(3) or 527 (such as 501(c)(4) and 501(c)(6) organizations) do not need to disclose a donor's name and address to the IRS on Schedule B. However, organizations must still maintain internal records with this information. This guidance was initially issued in mid-2018 through a Revenue Procedure and subsequently challenged in U.S. District Court. The court ruled against IRS on procedural grounds in July 2019. Final regulations were issued in May 2020 that set forth the new rules.

Mandatory Electronic Filing

Many exempt organizations already electronically file their Form 990, either because they are required to or have elected to do so for convenience. However, all organizations will soon be required to electronically file their tax returns under the Taxpayer First Act of 2019. Organizations who file a Form 990 or Form 990-PF are required to electronically file if their tax year begins after July 1, 2019. The thresholds for number of forms/returns filed with the IRS and value of assets have been eliminated. Organizations who qualify to file a Form 990-EZ have a one-year transition period and are required to electronically file if their tax year begins after July 1, 2021. Until then, the IRS will continue to accept paper filed Form 990-EZ returns.

There has been no change to electronically filing the Form 990-N, Electronic Notice (e-Postcard), which, as the name implies, is an electronic filing since its introduction in 2007.

Beginning in 2021, the IRS plans to have both the Forms 990-T and 4720 ready for electronic filing. These are applicable for the 2020 tax forms filed in 2021. These forms have never been available for electronic filing and it presents a challenge for the IRS to implement electronic filing at the same time as the other tax returns. Therefore, stay tuned for more information on the mandatory electronic filing of these forms.

Fair Labor Standards Act (FLSA)

On September 24, 2019, the Department of Labor (DOL) announced its final rules updating the salary threshold for the “white collar” exemptions. The new rule increases the exempt minimum salary threshold to \$684 per week (\$35,568/year) and goes into effect on **January 1, 2020**. The previous threshold was \$455 per week (\$23,660/year). The DOL estimates the rule change will allow an additional 1.2 million workers to become eligible for overtime pay under the FLSA.

Employers should analyze the status of employees who earn below the new minimum salary threshold previously classified as exempt. Employers will need to either raise salaries for exempt employees or reclassify these employees as non-exempt and eligible for overtime.

Other Issues:

Accountable plans

All employers must have a written expense reimbursement plan to exclude the reimbursement of ordinary and necessary business expenses from employee compensation. Employees must submit receipts with the required data and within required time frames to ensure reimbursements are not treated as taxable income to the employee. Qualified accountable plans and related documentation is a fruitful area for IRS audits. The TCJA made changes to the deductibility of certain expenses for income tax purposes, which impacts the types of expenses eligible to be reimbursed under an accountable plan. If your organization’s accountable plan has not been refreshed to incorporate TCJA changes, we recommend a review of your plan. This review may help prevent an automatic excess benefit transaction when making certain reimbursements to disqualified persons.

Compensation Studies

Most nonprofit organizations are either required to, or desire to, ensure compensation paid to employees is reasonable and not excessive. Public charities, as well as organizations exempt under Code Sec. 501(c)(4) and 501(c)(29), must establish reasonable compensation for disqualified persons, those in a position to substantially influence the affairs of the organization, to prove to the IRS that compensation is reasonable.

Often, organizations other than public charities and those exempt under Code Sec. 501(c)(4) and 501(c)(29) also want to establish reasonable compensation for many reasons. One step in this process is obtaining comparable compensation information, and [a compensation study](#) is one method to accomplish this. A compensation study considers the job requirements, location, size of the organization, and other facts to provide benchmarking data for a reasonable range of compensation for a position in a given market.

IT and Software Services

In the remote work environment that many organizations are now facing, risk management looks different than what it did previously. IT and Software Services Technology touches every aspect of an organization, from financial systems to smart devices to the computers on employees' desks or home offices. It is critical to manage and mitigate your risk around technology to safeguard your assets. Clark Nuber can help. Our services include:

- Service Organization Controls reports (SOC 1, 2, and 3)
- IT audits
- Management report baselining
- Security reviews
- Cybersecurity and risk assessments
- IT consulting
- Microsoft Supplier Security and Privacy Assurance (SSPA) services
- Software Functional Needs Assessments and Gap Analysis
- Accounting System/ERP Sales, Implementation, and Training

Questions?

If you have questions regarding any of the tax, audit, or accounting issues, or would like to set up a meeting, please [contact any of our not-for-profit professionals](#).

If you would like to receive the Clark Nuber NFP Newsletter, please [click here to subscribe](#).