



Association IRS Audits War Stories and Lessons Learned

National Association Conference

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Chicago, Illinois

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Learning Objectives

- Identify risk areas/areas of concern for the IRS
- Distinguish between advertising and sponsor acknowledgements
- Identify the tax consequences of affinity contracts
- Understand when royalty income becomes taxable





Compensation/Bonuses

What to Look For:

- Compensation seems significantly larger than comparable organizations
- Compensation is not set by independent, disinterested persons
- Individual's hours do not justify the compensation
- Executives holding positions for which they are not qualified
- Accomplishments and results do not justify the compensation/bonus

Why it Matters:

- Intermediate sanctions exist to curb inurement to disqualified persons who have substantial influence over the organization. In extreme cases, tax-exempt status can be revoked.
- An excess benefit transaction occurs when the economic benefit provided by the organization exceeds the value of the consideration received.



Compensation/Bonuses

What to Look For:

- Compensation for officers and key employees is NOT determined by independent members of the governing body or compensation committee
- Compensation levels are being set without regard to comparability data for similar positions at similar organizations
- Organization is not documenting the decision-making process

Why it Matters:

- If these procedures are followed, the compensation will be presumed to be reasonable under the excess benefit rules. Excise taxes can then be imposed only if the IRS develops sufficient contrary evidence to rebut the organization's evidence (the burden of proof shifts to the IRS to prove that the compensation is unreasonable).



Independent Contractors

What to Look For:

- Workers classified as independent contractors who: appear to have set working hours, receive significant training, follow specific instructions, are paid based on time instead of by the job, aren't working for any other employer, and who can be fired even if the job specifications are met.

Why it Matters:

- To determine whether an employment relationship exists between the individual and the organization for federal employment tax purposes. When the organization has the right to control and direct not only what is done but how it is done, the relationship may be that of employer and employee. Penalties for worker misclassification are severe. An organization that fails to file a required 1099 is subject to 28% backup withholding.



Joint Ventures

What to Look For:

- The nonprofit organization is the General Partner in a partnership in which individuals or commercial entities are limited partners.

Why it Matters:

- Exempt status is jeopardized unless the activity furthers the exempt purpose and the partnership agreement allows the general partner to act exclusively in the interests of the exempt purpose. The nonprofit must be in control of the venture, and must explicitly put the mission ahead of profitability.



Supporting Organizations

What to Look For:

- A 501(c)(3) public charity classified as a supporting organization under 509(a)(3) that supports a 501(c)(4), (5), or (6) organization.

Why it Matters:

- The supporting organization must confirm that the supported organization satisfies the public support test described in 509(a)(2).



Mailing List Rental

What to Look For:

- Sale or rental of mailing lists to nonprofit or commercial organizations
- Any services provided along with the mailing list

Why it Matters:

- The rental or exchange of mailing lists between exempt organizations is not taxable. However, if the Organization provides any additional services, the payment may be treated as an unrelated trade or business.



Conventions/Trade Shows

What to Look For:

- The organization conducts a trade show where vendors exhibit their products and services and promote public interest in the industry.

Why it Matters:

- Income from such activity is excluded from UBI only when the activity is carried on by a qualifying organization in conjunction with a qualified convention or trade show. The purpose of the activity should be educating members, promoting products and services of the industry, or educating persons attending the show concerning new developments or products and services related to the exempt activities.



Conventions/Trade Shows

The Bottled Water Association (BWA) is a 501(c)(6) trade association. It's mission includes supporting and enhancing activities within the industry, acting as a spokesperson for the industry, providing members with current information on technical developments, training methods, and economic issues, encouraging and fostering higher safety and technical standards, promoting technological advancements and improvements, and gathering and disseminating information about markets and products.



Conventions/Trade Shows

BWA conducts semi-annual trade shows to promote and stimulate demand for bottled water products. BWA plans and directs the show, secures the facility, charges admission, charges for rental of exhibitor space, and sells refreshments. There are educational seminars, and members and suppliers display products and services. Sales are permitted. Members, nonmembers, and potential customers attend the shows. Revenues from the shows are used to defray the shows' operating costs, and any net income is used in furtherance of BWA's exempt purposes.



Conventions/Trade Shows

BWA has an Internet website available to the general public 24 hours a day, 7 days a week for two weeks, after which the website is removed. It does not overlap or coincide with any convention, annual meeting, or show conducted by BWA. The website permits members and the public to access information and visual displays, such as product directories and specific product listings, and contains links to the websites of BWA's members and suppliers. The website contains order forms, and allows on-line purchases from members and suppliers appearing. BWA charges a fee to those who wish to have information listed on the website.



Advertising/Sponsorships

What to Look For:

- Corporate donations that oblige the nonprofit to provide anything in return, including acknowledgement of the gift

Why it Matters:

- While return benefits, most frequently advertising, may be taxable, a qualified sponsorship payment is not. To qualify as a sponsorship, there must be no arrangement or expectation of a substantial return benefit to the donor. Mere acknowledgement is not a return benefit.



Advertising/Sponsorships

Advertising

- Any message or material which promotes or markets any trade, business, service, facility or product:
 - Qualitative or comparative language
 - Price information or other indications of savings or value
 - Endorsements
 - Inducement to purchase, sell, or use any company, service, facility or product
 - A single message that contains both advertising and an acknowledgment is advertising



Advertising/Sponsorships

Sponsorship Acknowledgement

- Exclusive Sponsor arrangement
- Name, Address, Phone number, website, logo
- General description of the product line (“retailer of fine bathroom fixtures”)
- Visual depictions of the products and services
- Taglines (“The Ultimate Driving Machine”)
- Display or distribution of products



Advertising/Sponsorships

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Advertising/Sponsorships



Advertising/ Sponsorships



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Contractual Obligations

What to Look For:

- Contracts or other agreements that obligate the nonprofit to perform certain acts or services in exchange for payment. For example, in exchange for a large donation, the nonprofit agrees to encourage its members to use the donor's goods and services, send out letters or emails to its members, monitor and report on results, etc.

Why it Matters:

- Services provided by an exempt organization to a donor can result in a substantial return benefit to the donor without advancing the mission. The organization should make a good-faith estimate of the fair market value of the services it is providing, and consider whether that portion of the payment is exempt-function income or UBI.



Contractual Obligations

The Bottled Water Association conducts a conference with exhibitors.

Exhibitors pay \$5,000 for a booth, and attendees pay \$1,000/person.

The Platinum Sponsor pays \$50,000 and receives:

- Link from website
- Logo on tote bag
- Free booth at the trade show
- 6 admission tickets
- Right to introduce the keynote speaker
- 2 full page ads in the monthly magazine (FMV of \$4,000/each)

How should the payment be shown on Form 990?



Contractual Obligations

The Kids Hockey Foundation has a mission of mentoring troubled youths and giving them the opportunity to learn challenging skills through a structured athletic program.

The Foundation holds a celebrity golf event and reception dinner.

Platinum Sponsorship Package - \$25,000

- Sponsorship recognition
- 4 rounds of golf with a pro hockey player
- Brunch, dinner with all attendees
- Swag



Contractual Obligations

Thank you for your Platinum Sponsorship of our Celebrity Golf Event. We received your contribution for \$25,000, and we are most grateful for your support! A large portion of your sponsorship is tax deductible. As part of your sponsorship, you received goods/services associated with the event with an estimated fair market value of \$144; therefore, the deductible portion is \$24,856.

Your generous support of the Kids Hockey Foundation will help us continue to advance our mission to improve the lives of disadvantaged children in the region.

**On behalf of the Foundation's Board of Directors,
thanks again for your generous support.**



Contractual Obligations

- \$184 Green fees per golfer
- \$146 Brunch, cocktails, dinner
- \$16 Photo plaque
- \$59 Golf Trophy
- \$85 Autographed hockey jersey
- \$50 Polo shirt and hat
- \$15 Golf balls
- \$50 Gift certificate to golf pro shop
- \$300 Gift certificate for team fan gear
- \$905 Total



Contractual Obligations

Thank you for your \$25,000 payment for the Platinum Sponsorship of our Celebrity Golf Event. You received goods/services associated with the event with an estimated fair market value of \$3,620.

Your generous support of the Kids Hockey Foundation will help us continue to advance our mission to improve the lives of disadvantaged children in the region.

On behalf of the Foundation's Board of Directors, thanks again for your generous support.



Contractual Obligations

Ted,

The notion that anyone received goods and services worth 900.00 dollars per golfer is ridiculous.

Your accountant's position is nonsense. The entire cost of the outing should not be shifted to the sponsors as goods and services.

You continue to try and punish those that are trying to help you.

I suggest you revisit this position.

By the way , no one else does this.

Sincerely,

Dan

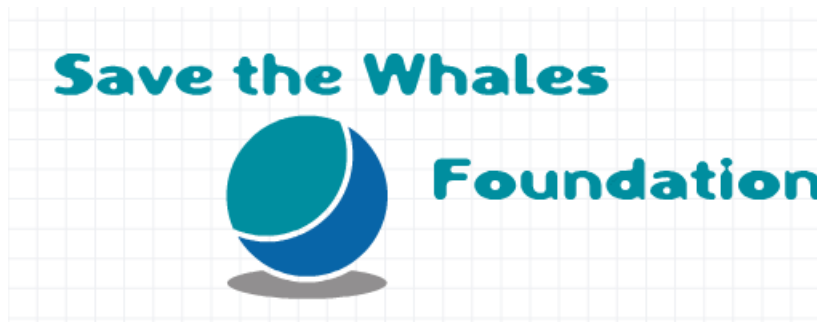


Analyzing Contracts

\$100,000 License Agreement

Trial Balance/Audited Financial Statements

- Contribution?
- Sponsorship?
- Royalty?



Analyzing Contracts

The Save the Whales Foundation
signs an agreement with Flyover Country Airlines.

The Foundation will

- Grant a license to use its trademarks
- Provide a quarterly membership list, including physical and email addresses
- Send an email to its members, promoting the affinity agreement with Flyover
- Insert Flyover's promotional material in its membership renewal notices
- Put Flyover's logo on its homepage, with a hyperlink
- Identify Flyover as the "preferred" airline of the Save the Whales Foundation
- Provide educational content to be featured on Flyover's website

Analyzing Contracts

The Save the Whales Foundation signs an agreement with Flyover Country Airlines.

The Airline will

- Obtain written approval of all promotional material using the trademarks
- Paint the Foundation's logo and a depiction of a humpback whale on the body of 10 planes
- Pay a sponsorship of \$100,000
- Pay the Foundation 1% of all tickets purchased by individuals following the hyperlink from the Foundation's website
- Pay the Foundation 1% of all tickets purchased by members responding to a solicitation from Flyover

Conclusion

Special scrutiny is paid to:

- Executive Compensation
- Employee Classification
- Unrelated Business Income
- Governance Policies





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