Impact of the CARES Act and Economic Uncertainty on Financial Reporting and Presentation

November 3, 2020

WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING

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Create Opportunities

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- *This presentation considers guidance provided by the SBA and US Department of the Treasury through 10/16/2020. Additional guidance is being provided on a regular basis, please refer to the US Department of the Treasury website (https://home.treasury.gov/policy-issues/cares/assistance-for-small-businesses) for recent updates.*

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Presenters

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Learning Objectives

At the end of the session, you will be able to:

- Discuss the most recent developments in COVID-19 response legislation, such as the CARES Act.
- Recognize the various scenarios of how funding impacts financial reporting.
- Discuss the employment tax and 990 reporting impacts of the funding and key red flags that organizations should watch for.

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Cumulative PPP Data

5.2 million loans in total

$525B total PPP approved dollars

5,460 participating lenders

3.7% of all PPP loans went to nonprofits

~180,000 nonprofit loans impacting 4.1M Jobs

An est. 40% of eligible nonprofits received PPP loans

SBA.gov and Johnson Center of Philanthropy study by Jeff Williams

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Recent Updates

- SBA opened its portal 8/10/20 to begin receiving forgiveness applications from banks.
- Many banks are just opening their portals in October, or limiting applications to those taking the 8 week covered period.
- Recently heard of first loans being issued forgiveness by the SBA!

Recent FAQ highlights:

August 4
You can "squeeze in" an extra payroll if you paid a payroll after the start of your CP/APCP for work in prior periods. For some, this will allow them to hit 100% forgiveness in the 8 week period.

October 2
Change in ownership guidance

October 8
Streamlined forgiveness for loans under $50k (3508S)

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Forgiveness Process

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Timing

Borrower may submit any time on or before maturity

- Includes DURING the covered period
- Must have used all proceeds for which borrower is requesting forgiveness
- Still need documentation (e.g. Form 941)

Lender will have 60 days and SBA will have 90 days for review

Forgiveness requested within 10 months after covered period ends

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SBA Review Procedures

Will have 6 years to review

Elements of review

- Eligibility (except for “necessity” safe harbor if < $2 million)
- Loan amount and use of proceeds
- Loan forgiveness

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Loan Forgiveness Applications

3508S

- Loan of $50,000 or less and total amount with affiliates is less than $2M
- Fewer calculations and less documentation required
- Exempt from FTE or wage reduction implications

3508 EZ

- Self-employed with no employees, or
- No reductions to FTE or wages during your covered period, or
- No reduction to wages and were unable to operate at same level as 2/15 due to COVID

3508

- "Standard" application required if ineligible for prior two
- Allows for 8 or 24 week covered period, with option to apply in between, though questions remain.
- Schedule A includes significant employee level detail required for submission

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Information to Submit

Specific information and level of detail will vary by bank, so check with your lender.

Most will require:

- Proof of compensation – third party payroll reports, bank statements
- Form 941 (variation on requirements when CP includes current quarter)
- Benefit statements, with reconciliation for employer vs. employee paid
- Quarterly state tax filings for unemployment insurance
- Invoices and proof of payment for all non-payroll costs
  - Some may require proof verifying that the contract was in place prior to 2/15/2020

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Forgiveness Calculation

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PPP Basics: What's Eligible for Forgiveness

Payroll Costs

- **Salaries, wages** (includes PTO, sick pay, separation payments, etc.) – limited to $100,000 annualized
- **Group health care benefits**
- **Retirement benefits**
- **Employer portions of state/local payroll taxes**

+

Non-Payroll Costs

- **Interest on Mortgage Obligations**
- Rent
- Utilities

Covered Period: 24 weeks or 8 weeks (for loans before June 5)

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Covered Period

24 week covered period

- Available for all loans since PPP inception
- Only period available for loans originated after June 5th
- Borrower can file loan forgiveness application before the end of the 24 week covered period (***missing guidance***)

8 week covered period

- Borrower with loan originated before June 5th can elect to use the original covered period term

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How do I choose?

- If you are able to maximize forgiveness in 8 weeks (which is somewhat rare), it may be simpler to choose this option and apply (fewer unknowns).
- Otherwise, 24 weeks or “up to” will likely make more sense and may simplify your application, as you can likely maximize forgiveness using only payroll costs.
- Questions about the Covered Period dates for applying between 8-24 weeks remain.
- At this point, most organizations have reached 24 weeks, and it is simplest to use a full 24 weeks and use payroll costs only.

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How does the covered period work?

- Time period to track costs for forgiveness
- 24 weeks (8-week option for loans before June 5)
- Option for Alternative Payroll Covered Period

Application Date: Any time on of before maturity (including during CP) if used all proceeds reported on forgiveness application. Note: Payments are only deferred for 10 months after CP.

April 1: PPP Application

April 27: First day of biweekly pay period

June 9: End of 8-week CP

April 15: Loan Funded

June 21: End of 8-week APCP

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Payroll Costs

- For bi-weekly or more frequent payrolls - ***Alternative Payroll Covered Period*** (***APCP***) starting first day of first pay period following PPP loan disbursement
- Flexibility to include costs incurred during CP or APCP and ***paid on or before next regular payroll date***
- Potential to include payroll costs incurred prior to the CP or APCP ***if paid during the CP or APCP***
- Subject to max during the period ($100,000 prorated for period)
- Non-cash payroll costs (healthcare, retirement, ER state taxes) must be paid during CP or APCP

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Payroll Costs – Limitations on Cash Compensation

8-week period

- Employees - based on comp during CP/APCP
- Max of $15,385/person

In-Between

- Unclear how the limitations will apply; awaiting guidance

24-week period

- Employees - $46,154 (24/52 * $100k max)

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Payroll Costs – Double Dipping Restriction

Limited Guidance Available

- Cannot use the same payroll costs for PPP that you have used for other restricted revenues
- Check with your funders on how they view their funds and your PPP; guidance varies.
- Also consider FFCRA credits- if you received them for employee wages, you can't use those wages for PPP.

Funding Structure Considerations

- Absent guidance from your funder, consider the nature of the funding. Is it a restricted grant that specifies use and requires reporting back on how it was spent? If yes, you should not use that payroll.
- Is it structured as a contract, whereby your organization receives a set rate (per day, per meal, etc.) and reporting back on how funds were spent is not required? Then it may not be restricted, and wages can be included.

How to Account for Payroll covered by Restricted Funds when applying for forgiveness?

- Include all employees in your listing (schedule A), but back out the payroll covered by restricted funding. (we believe all employees should be counted for FTE.

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Non-Payroll Costs

- Interest mortgage obligation
- Rent
- Utilities

- Contracts must be in place as of 2/15/20
- All the above are considered non-payroll costs

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Non-Payroll Costs

- Flexibility to include costs incurred during the CP if *paid* ***on or before next regular billing date***
- No prepayments of future interest on mortgage debt, but unclear about rent and utilities expenses
- Max forgiveness amount of 40% for non-payroll costs

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Accounting standards

- What accounting standards apply when accounting for PPP Loans?

Standards	Applicability	Applies to For Profit?	Applies to Nonprofit?
ASC 470, *Debt*	This is an option for any PPP loan	Yes	Yes
ASC 958-605, *Revenue Recognition (Not-for-Profit Entities)*	Option if meets eligibility criteria and concludes PPP loan represents, in substance, a grant that is expected to be forgiven	Yes*	Yes
ASC 450-30, *Gain Contingencies*	Same as ASC 958-605	Yes*	No

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How to account for the PPP Loan?

- How does the accounting differ under the various options?

Standards	Initial Recognition	Interest	Derecognition
ASC 470	Financial Liability [1]	Accrue Interest	Debtor has been "legally released" or pays off loan. Forgiveness is recorded as a gain on extinguishment.
ASC 958-605	Refundable Advance	n/a	Contribution recognized once the conditions of release have been substantially met or explicitly waived.
ASC 450-30	Liability	n/a	Grant proceeds recognized when all of the contingencies related to receipt of the assistance have been met and the gain is realized or realizable.

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Accounting under ASC 958-605

- If grant accounting under 605 is used, what are the barriers that should be considered?
- Judgement will be a factor
- *Always a barrier*:
  - Expects full or partial forgiveness
  - Paid eligible costs

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Accounting under ASC 958-605 - continued

Criteria	Factors Indicating it Might Be a Barrier	Factors Indicating it Might NOT Be a Barrier
Maintained FTEs and Wages relative to reference periods and/or met safe harbors	• Reductions are based on FTE counts and wages paid throughout an 8- or 24-week period (and in some cases through December 31, 2020) • ASC 958-605 does not permit recognizing based on probabilities. Even if probable, recognition is not permitted if there is a possibility the condition will not be met.	While we generally expect this will be considered a barrier, there may be some rationale for recording partial forgiveness based on actual FTEs and wages paid as of a reporting date. Here is an example: • Client's 8-week period ends before June 30. If they were to file an application based on that 8-weeks, they would have $800,000 forgiven of a $1M loan. Based on that, the barrier for $800,000 may have been removed by June 30. If they later apply for full forgiveness using the 24-week period, the remaining $200,000 could be recognized in a subsequent period.
Application and Review Process [5]	• SBA is continuing to make significant changes to PPP rules. We can be reasonably assured that more rules and limitations will be issued • Loan forgiveness rules specifically do not seem fully defined at this point in time. • Review process by SBA will include a review of overall eligibility. Many lenders relied on borrower certifications of eligibility, so this will be the first review of overall eligibility.	• Organization believes it clearly meets eligibility, including economic need, requirements. • Organization's eligible costs well exceed the amount of forgiveness being requested. • Organization's FTEs and wage rates well exceed levels needed for forgiveness. • Organization believes it clearly meets any safe harbors being used.

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Documentation to be maintained

- What documentation should be maintained to report under ASC 958-605, conditional contribution?

  - Organization believes it clearly meets eligibility, including economic need, requirements.
  - Organization's eligible costs well exceed the amount of forgiveness being requested.
  - Organization's FTEs and wage rates well exceed levels needed for forgiveness.
  - Organization believes it clearly meets any safe harbors being used.

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How does this impact debt covenants?

- Review debt agreements for nature of your debt covenants.
  - The legal form of the PPP funding is debt. Therefore, legally there is a loan agreement outstanding until "legally released" or paid off.
  - Derecognition of the liability under GAAP does not necessarily mean the entity has been legally released.
  - For example, if the entity has covenants in other debt instruments that restrict debt, a PPP loan would likely violate the covenant. This is true despite an entity calling it a refundable advance and potentially derecognizing it earlier than the legal release.
  - Additionally, consider how income from PPP loan forgiveness impacts debt covenants. In many cases, loan forgiveness or other income is excluded from financial covenants. Entities may need to clarify with lenders how calculations should be applied.
  - Entity may need to consider discussing with the lender or legal/bond counsel.

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PPP Loan Forgiveness

- How is the amount of forgiveness determined?
  - Eligible costs paid or incurred
    - ◊ 24 weeks from date of loan
    - ◊ If loan before June 5, can elect shorter 8 week period
    - ◊ Costs can be more or less than total proceeds; loan forgiveness is limited to loan amount
- Which form do I use, EZ or long form?

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Forgiveness - Continued

- Adjustments for FTE and Salary/Hourly Wage Reductions
  - ◊ Wage reductions in excess of 25% subtract dollar for dollar from eligible costs.
  - ◊ FTE Reduction Quotient is multiplied by all eligible costs less wage reductions.
  - ◊ Note there are numerous rules, safe harbors, and exceptions applicable to these reduction tests.

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Forgiveness - Continued

- Payroll Cost 60% Requirement
  - ◊ Nonpayroll costs in excess of 40% of the loan forgiveness amount are disqualified.
- Emergency Injury Disaster Loan Advance Reduction
  - ◊ Forgiveness is reduced by the dollar amount of the EIDL advance received.
  - ◊ EIDL advance can be an amount from $0-$10,000.

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Other Accounting Considerations in Economically Challenged Times

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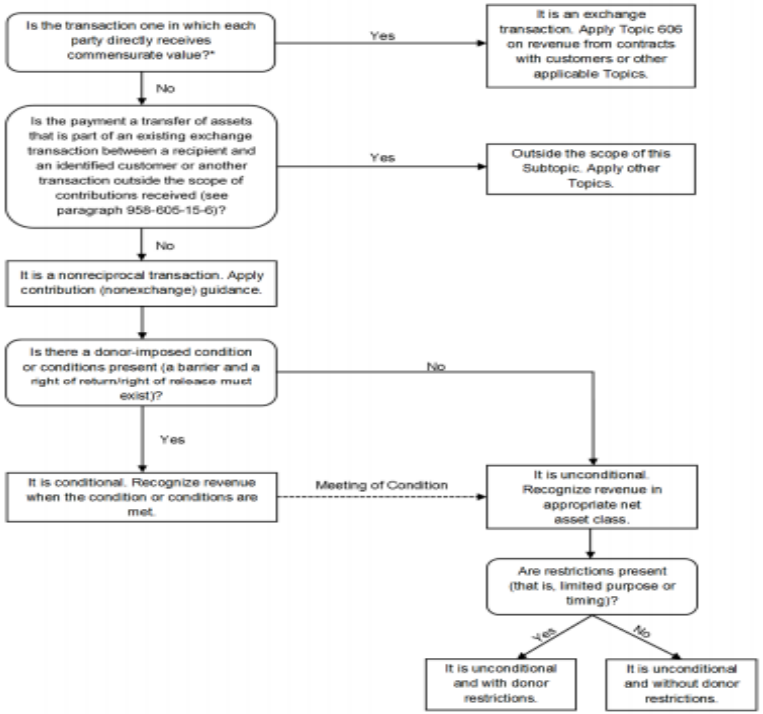
Other Accounting Considerations

- Refresh of the Changes to Revenue Recognition under ASC 958-605



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Other Accounting Considerations

- Special Event Reporting Considerations
  - Event is cancelled
    - ◊ Cost considerations – paid costs, incurred costs, contingencies
    - ◊ Treatment of tickets, sponsorships, etc. – refund or contribution?
  - Event is postponed
    - ◊ Sponsors and ticketholders agree to defer
    - ◊ Changes in costs paid or costs incurred
  - Event goes “virtual”

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Other Accounting Considerations - Continued

- Subsequent Event Reporting
  - Type I Event
  - Type II Event
  - Where did the event fall in relation to your fiscal year end? What are the facts and circumstances?

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Other Accounting Considerations - Continued

- Going Concern
  - Is disclosure necessary?
  - What factors should be considered?
  - What should we be communicating or documenting for our auditor?
- Contingencies and commitments

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Other Accounting Considerations - Continued

- Mergers, Acquisitions and other Business Combinations
  - Considerations for acquiring/merging organization
  - Considerations for acquired/merged organization
  - Disclosures

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Questions

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Resources

Treasury Website

- https://home.treasury.gov/policy-issues/cares/assistance-for-small-businesses

SBA Website

- https://www.sba.gov/funding-programs/loans/coronavirus-relief-options

CLA's COVID Relief Center - Bi-weekly Livestreams

- https://www.claconnect.com/COVID19

US Chamber of Commerce

- https://www.uschamber.com/coronavirus

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Trending and Red Flags in the Form 990 during Unprecedented Times

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Learning Objectives

At the end of the session, you will be able to:

- Identify areas of risk on Form 990 and the Schedules
- Identify what to avoid in preparing a Form 990
- Recognize how to minimize risk through disclosure

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WHAT TO DO RIGHT

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WHAT MAKES A 990 LOOK "GOOD"

Sounds like a beauty contest, and to a certain extent, it is.

Appearances do matter because funders, watch dogs and the IRS read the returns.

On the positive side, paying attention to the mission and program statements is a very good start.

The 990 provides space for a very brief mission statement on page 1. While excess verbiage will carry over to Schedule O, we suggest that the organization try to pare down their mission to fit in this space.

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FORM 990 PART I

Form **990**

Department of the Treasury
Internal Revenue Service

Return of Organization Exempt From Income Tax

Under section 501(c), 527, or 4947(a)(1) of the Internal Revenue Code (except private foundations)

▶ Do not enter social security numbers on this form as it may be made public.

▶ Information about Form 990 and its instructions is at *www.irs.gov/form990*.

OMB No. 1545-0047

2015

Open to Public Inspection

A For the 2015 calendar year, or tax year beginning , 2015, and ending , 20

B Check if applicable:
- ☐ Address change
- ☐ Name change
- ☐ Initial return
- ☐ Final return/terminated
- ☐ Amended return
- ☐ Application pending

C Name of organization

Doing business as

Number and street (or P.O. box if mail is not delivered to street address) | Room/suite

City or town, state or province, country, and ZIP or foreign postal code

D Employer identification number

E Telephone number

G Gross receipts $

F Name and address of principal officer:

H(a) Is this a group return for subordinates? ☐ **Yes** ☐ **No**

H(b) Are all subordinates included? ☐ **Yes** ☐ **No**

If "No," attach a list. (see instructions)

I Tax-exempt status: ☐ 501(c)(3) ☐ 501(c) ( ) ◀ (insert no.) ☐ 4947(a)(1) or ☐ 527

J Website: ▶

H(c) Group exemption number ▶

K Form of organization: ☐ Corporation ☐ Trust ☐ Association ☐ Other ▶

L Year of formation:

M State of legal domicile:

Part I Summary

nance

1 Briefly describe the organization's mission or most significant activities:

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HIGHLIGHTING YOUR MISSION AND SERVICES

On page 2 of the 990, you really get a chance to shine!

First you get rather more space to describe your mission. If you need more space, the disclosure is carried to Schedule O.

That's fine here, as the reader is more committed to finding out about the organization if they have moved on to page 2.

1 Briefly describe the organization's mission:

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PROGRAM SERVICE ACCOMPLISHMENTS

Page 2 is also where you describe your 3 largest programs as determined by their costs. The remaining programs, if any will be described in Schedule O.

- Describe them fully.
- Provide details of the numbers of clients served, if applicable.
- Provide details of the number of volunteers and the hours of service they provide, if applicable.
- Discuss the results – successes of programs undertaken.
- Understand what the numbers requested are for.

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FORM 990 PART III

4a (Code: _____) (Expenses $ _____ including grants of $ _____) (Revenue $ _____)

Expenses means the direct and indirect expenses for that program. The total of the expenses for the 3 largest programs and the smaller ones MUST equal the total program expenses reported on Part IX of the return.

The grants listed are also included in the total expenses disclosed.

Revenue is service revenue earned by that program, not contributions.

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THE LITTLE THINGS

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You want the readers of your tax returns to know that your organization is a professional, well-run organization that is capable of accomplishing its mission. Again, appearances count:

- Is the return complete? Have the questions been answered, have the disclosures been made? Sophisticated readers know what should be there.
- Is it literate? In other words, has the spelling and grammar been checked? If you can't read and write, what else can't you do?

WHAT TO WORRY ABOUT – WHAT WORRIES THE IRS AND OTHER READERS

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EXECUTIVE OFFICER COMPENSATION

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Is the organization paying reasonable salaries to its officer-level employees?

If not, the IRS may determine that an “excess benefit transaction”.

The penalties associated with an excess benefit transaction can be:

- A 25% excise tax imposed on the individual receiving it, and/or
- A 10% excise tax on the managers who approved it.

The officer excise tax is capped at $20,000.

EXECUTIVE COMPENSATION – SAFE HARBOR

- REG. 53.4958-6(a) sets out a 3-step safe harbor for determining officer/disqualified person's compensation. It will not guarantee that the IRS accepts it, but if these steps are followed, the burden of proof is on the Service to prove unreasonableness.

1. The compensation is approved in advance by the organization's governing body (or committee thereof) that is composed of people that do not have a conflict of interest with respect to the agreement.
2. The governing body relies on appropriate comparable data in deciding whether to approve the compensation.
3. The governing body adequately documents its actions at the time that they are taken.

- As with all IRS pronouncements there are critical definitions to take into account, but this is the meat of it.

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WORRY AB0UT FILING PAYROLL TAX RETURNS

Seems obvious, but it does not always happen.

- Are all of your independent contractors receiving 1099s?
- If you are reporting a raffle as part of your fundraising activities, were the winners issued W-2Gs if it was appropriate?
- Are taxable fringe benefits being reported as income on either the employee's W-2, or the contractor's 1099?
- In IRS audits, this is an area that they ALWAYS look at.

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WORRY ABOUT OTHER EXCESS BENEFITS

Specifically theft, fraud and embezzlement.

- Every organization worries about these from a purely operational standpoint.
- The tax code considers these to be forms of excess benefit transaction because someone has received a benefit to which they were not entitled.
- If that has happened, it must be reported on the return. The required disclosures should disclose the crime, how it was resolved (if it was) and what the organization is doing to prevent a recurrence.

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WORRY ABOUT BEST PRACTICES

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Page 6 of the 990 has 2 sections. The focus here is on the governing body, management and policies.

These questions are a really good guide to what the best practices of any organization should be. The IRS cannot compel adherence to best practices, but the Service believes that a well run organization is more likely to be operating and reporting correctly than one that is not well run.

WORRY ABOUT UBTI

UNRELATED BUSINESS TAXABLE INCOME (UBTI)

Unrelated business income (UBI) is defined by §513(a) as "… any trade or business the conduct of which is not substantially related … to the exercise or performance by such organization of its charitable, educational or other purpose or function constituting the basis for its exemption under section 501…"

To be UBI, the activity must be a trade or business, that is regularly carried on and which is "not substantially related" to the organization's exempt purpose.

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WHAT IS NOT UBI

Some unrelated business activity is actually excluded from treatment as UBTI:

- Royalties,
- Real property rentals that are NOT debt financed,
- Investment income (dividends, interest, capital gains),
- Businesses where substantially all the work is done by volunteers, or
- Sales of donated items, and activities carried on for the benefit of members, students, patients, officers and/or employees.

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THINGS TO AVOID ON YOUR FORM 990

- This is a random list of things that tend to jump out as a problem or potential problem on Form 990:
- Incomplete forms and schedules,
  - Inconsistency between one part of the form and another,
  - Lending money to an officer or director,
  - Failure to disclose business relationships between the organization and officers/directors/trustees,
  - Failure to correctly report fundraising events, and
  - Failure to correctly report functional expenses.

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MITIGATING RISK THROUGH DISCLOSURE

Transparency is key:

- ❑ **Where the IRS asks for information, provide it.**
- ❑ **Where the answer to a question is not what it "should" be, explain.**
- ❑ **When there is no other way to tell the whole story, add a disclosure.**

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