

THE PPC NONPROFIT UPDATE

AUGUST 2021, VOLUME 28, NO. 8

Supreme Court Gives the First Amendment Some Breathing Space

In a 6-3 decision released on July 1, 2021, the Supreme Court ruled that California cannot demand a copy of Form 990 Schedule B, including the names and addresses of donors, from charitable organizations [*Americans for Prosperity Foundation v. Bonta*, 127 AFTR 2d 2021-813 (S. Ct 2021)].

Background

The California Attorney General's Office is responsible for statewide supervision and regulation of charitable fundraising. Like many states, California requires charitable organizations soliciting donations within the state to register with the Attorney General. However, California requires something that most other states do not—a complete copy of the organization's Form 990 Schedule B including the names and addresses of donors who gave more than \$5,000 or, in special circumstances, donors who gave more than 2% of total contributions for the year. The state contended that the up-front collection of the names and addresses of major

donors was useful for identifying potential fraud, self-dealing, and other misconduct.

Many charities renew their registrations with the state of California each year. Since 2001, California regulations have required registering charities to provide a complete Form 990 Schedule B. Certain charities continued to provide copies of Form 990 Schedule B with the names and addresses of the donors redacted. In 2010, California threatened such charities, including the Americans for Prosperity Foundation and the Thomas More Law Center (the petitioners), with fines and suspension. The two charities sued the state, alleging that the requirement violated their rights and the rights of their donors ("as-applied" challenge) as well as the rights of all other affected nonprofits ("facial" challenge). The District Court ruled in their favor and prohibited California from collecting the information, concluding that the requirement was not narrowly tailored to the state's interest in investigating misconduct and that it created an unconstitutional burden on the



In this Issue:

- Supreme Court Gives the First Amendment Some Breathing Space
- Tax Briefs
- AICPA Releases 2021 Nonprofit Risk Alert
- GAO Issues COVID-19 Recommendations
- Auditing Brief



freedom of associational rights of the donors. However, the 9th Circuit reversed the District Court, rejected the facial challenge, and rejected the as-applied challenge provided that California did not publicly disclose the information.

Nearly 300 organizations filed or signed on to “friend-of-the-court” briefs opposing California’s requirement, underscoring the gravity of the privacy concerns. Far from representing uniquely sensitive causes, these organizations spanned the ideological spectrum, including the ACLU, the NAACP, PETA, and the Human Rights Campaign.

The Petitioners’ Argument

The petitioners alleged that Form 990 Schedule B disclosure would make donors less likely to contribute and subject those donors to the risk of reprisals. Evidence indicated that both organizations and their supporters had been subjected to bomb threats, protests, stalking, and threats of physical violence.

Testimony in the case indicated that California officials rarely used Schedule B information to audit or investigate charities and that they could obtain this type of information from other sources. Furthermore, California had a history of failing to ensure the confidentiality of donors’ information. During the course of litigation, the Americans for Prosperity Foundation identified nearly 2,000 confidential Schedule Bs that had been posted to the Attorney General’s website.

The State’s Argument

The California Attorney General argued that alternative means of obtaining Schedule B information, such as audits and subpoenas, are less efficient and effective than up-front collection. A targeted request for donor information could cause a charity engaged in fraud to hide or tamper with evidence. Additionally, there was no significant risk to donors that California’s requirement would result in any “broad-based chill” since California’s Schedule B requirement is confidential.

The State also suggested that many donors seek the publicity that comes from being a major supporter of a cause they believe in and welcome the public disclosure of their support. In addition, many charities will sell the names and addresses of donors to other organizations, most charities are noncontroversial, and publicity would not deter donations. There is no additional burden on the donors because their identifying information is already being provided to the IRS.

The Court’s Ruling

The majority opinion was written by Chief Justice Roberts and joined in full by Justices Kavanaugh and Barrett. The Supreme Court concluded it does not make a difference in these cases if there is no disclosure to the public, if some donors do not mind having their identities revealed, or if the relevant donor information is already disclosed to the IRS as a condition of federal tax-exempt status. California’s disclosure requirement imposes a widespread burden on donors’ associational rights, and this burden cannot be justified on the ground that the regime is narrowly tailored to investigating charitable wrongdoing, or that the State’s interest in administrative convenience is sufficiently important.

The opinion further concluded that California does not rely on Schedule B information to initiate investigations. There are multiple alternative mechanisms through which the Attorney General can obtain Schedule B information after initiating an investigation. The need for up-front collection is particularly dubious given that California—one of only three States to impose this requirement—did not rigorously enforce the disclosure obligation until 2010. The Court commented that California’s interest is less in investigating fraud and more in ease of administration. This interest, however, cannot justify the disclosure requirement.

The Court opined further that the prime objective of the First Amendment is not efficiency. Mere administrative convenience does not remotely “reflect the seriousness of the actual burden” that the demand for Schedule Bs imposes on donors’ association rights. Disclosure requirements can chill association even if there is no disclosure to the general public. While assurances of confidentiality may reduce the burden of disclosure to the State, they do not eliminate it.

In the majority’s view, it does not matter that the IRS already collects the information that California is seeking. “Each governmental demand for disclosure brings with it an additional risk of chill.” The IRS has reasons for requesting the data, such as revenue collection efforts and conferral of tax-exempt status, that are not relevant to California. The Court concludes that the Attorney General’s disclosure requirement imposes a widespread burden on donors’ associational rights that cannot be justified on the ground that the regime is narrowly tailored to investigating charitable wrongdoing, or that the State’s interest in administrative convenience is sufficiently important. The Court ruled that the up-front collection of Schedule B is facially unconstitutional. When it comes to the freedom of association, the protections of the First Amendment are triggered not only

by actual restrictions on an individual's ability to join with others to further shared goals. The risk of a chilling effect on association is enough, because First Amendment freedoms need breathing space to survive.

Determining the appropriate standard. The majority opinion finds that the appropriate standard for evaluating the constitutionality of California's requirement is *exacting scrutiny*, which seeks a substantial relationship between the disclosure requirement and a sufficiently important governmental interest, rather than *strict scrutiny*, which means that the government must adopt the least restrictive means of achieving a compelling state interest. In a concurring opinion, Justices Alito and Gorsuch "agree that California's blunderbuss approach to charitable disclosures... is facially unconstitutional." However, they "do not read our cases to have broadly resolved the question in favor of exacting scrutiny," nor do they see the need to decide which standard should be applied here or whether the same level of scrutiny should apply in all cases in which the compelled disclosure of associations is challenged under the First Amendment. In a separate concurrence, Justice Thomas states that strict scrutiny should be the standard used. He expresses further concern that "the Court has no power to enjoin the lawful application of a statute just because that statute might be unlawful as-applied in other circumstances."

The Dissenting Opinion

In a dissent written by Justice Sotomayor and joined by Justices Breyer and Kagan, Justice Sotomayor expresses concern that the majority opinion could endanger other forms of reporting and disclosure, such as political campaign contributions. The dissent notes that the ruling overturns California's disclosure requirement "even if a plaintiff demonstrates no burden at all. The same scrutiny the Court applied when NAACP members in the Jim Crow South did not want to disclose their membership for fear of reprisals and violence now applies equally in the case of donors only too happy to publicize their names across the websites and walls of the organizations they support."

Other Comments on Ruling

California's current Attorney General, Rob Bonta (D), stated, "Stripping our office of confidential access to donor information—the same information about major donors that charities already provide to the federal government—will make it harder for the state to fight fraud and prevent the misuse of charitable contributions."

Americans for Limited Government President Rick Manning stated, "This is great news for people on all sides of the political spectrum to be able to engage in political advocacy without risking their personal and professional safety."

Practical Consideration:

In light of the Supreme Court decision, organizations are assured that reporting confidential information (e.g., donor information reported on Form 990, Schedule B) will no longer be required to be submitted to state attorney generals as part of an annual reporting.



Tax Briefs

IRS Encourages Electronic Filing. The IRS is encountering delays in processing paper returns, including Form 990-EZ [Short Form Return of Organization Exempt From Income Tax] and Form 8868 [Application for Extension of Time to File an Exempt Organization Return]. The IRS recommends filing forms electronically to avoid premature notice of non-filing or delayed notice approving the organization's extension request. However, if the organization has already filed a paper return, it should not file a second return, nor contact the IRS about the status of its paper-filed return. The IRS also encourages all organizations to file Form 4720 electronically (currently only private foundations are required to file electronically).

IRS Modifies Time Frame for Approving Streamlined Tax-exemption Application. The IRS has issued a memo updating its internal procedures for processing Form 1023-EZ [Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code]. Among other things, the memo revises the time frame for it to assign cases to review Form 1023-EZ. The memo's interim guidance, which is in effect until 5/13/23 [at which point the guidance will be incorporated into the Internal Revenue Manual (IRM)], states that the time frames for assigning cases under IRM 7.20.9.3 are modified as follows: (1) cases are assigned to a tax examiner within 11 workdays from the submission date; (2) a specialist will respond to a request for involvement within two workdays; and (3) pre-determination review and tax examiner referral cases are assigned to a specialist within 15 workdays from the submission date. TE/GE-07-0521-0008 is available at www.irs.gov/pub/foia/ig/tege/tege-07-0521-0008.pdf.



AICPA Releases 2021 Nonprofit Risk Alert

This year's AICPA Audit Risk Alert (Alert), *Not-for-Profit Entities Industry Developments—2021*, has been released, and much of the information is helpful to auditors and nonprofit organization managers alike. This article summarizes key features of the 2021 edition.

Economic and Industry Developments

This section provides information about key economic indicators and how nonprofit organizations fit into the economy. Specific factors to consider include the following:

Current Economy. The U.S. economy is continuing to experience uncertainty from the COVID-19 pandemic. The National Bureau of Economic Research (NBER) declared the United States was in a recession beginning in February 2020 based on the extent of the decline in employment and production across the United States. There was an unprecedented level of government assistance, including the Coronavirus Aid, Relief, and Economic Security (CARES) Act stimulus package passed in March 2020 that provided \$2 trillion to businesses and households and created the Paycheck Protection Program (PPP) that funded forgivable loans to qualifying businesses facing economic hardships caused by the pandemic. Extensive legislation was passed in 2020 and 2021 to stimulate the economy and to provide assistance to families, small businesses, and nonprofit organizations. There were some signs of recovery late in 2020, but as of the time of publication of the Alert, the NBER had not declared an end to the recession.

Current Economic Indicators. The Bureau of Economic Analysis reports Real GDP, which measures output of goods and services by labor and property within the U.S., declined 5% in the first quarter of 2020 and 31.4% more in the second quarter (the biggest decline since 1947), followed by increases of 33.4% in the third quarter, and an increase at an annual rate of 4.1% in the fourth quarter (compared with an increase for 2019 of 2.1%). The fourth quarter results reflect economic recovery from earlier in the year along with continuing restrictions and closures as a result of the pandemic.

The unemployment rate was 6.7% in December 2020, which is an improvement from the 14.7% rate in April 2020 but still almost double the 3.5% rate in February 2020 pre-pandemic. The rate of unemployment at the end of 2020 represents approximately 10.7 million people out of work (compared to 5.8 million at the end of 2019), excluding the 6.2 million part-time workers unable to find full-time work at the end of 2020 (4.1 million in 2019), as well as the 7.3 million people (1.2 million in 2019) who have given up looking for work

altogether or were unavailable to take a job. The Bureau of Labor Statistics reports that, although year-over-year employment metrics are down, they reflect the fact that activities stopped or reduced in early 2020 due to the pandemic are resuming.

Although the federal minimum wage rate remains unchanged at \$7.25 since 2009, 24 states and Washington, D.C. will increase their minimum wages in 2021. This will result in 29 states and Washington, D.C. having minimum wages above the federal minimum wage.

The housing market experienced a boom in 2020 due to record-low mortgage rates and price increases as a result of high buyer demand, including more relocations as a result of more employees working remotely due to the pandemic.

The Federal Reserve took a number of actions in 2020 to respond to the pandemic, including cutting the federal funds interest rate to zero and directing the purchase of corporate bonds for the first time. It decreased the federal funds rate two times during 2020 (compared with three decreases in 2019).

State of Nonprofit Organizations. There are currently over 1.5 million IRS-registered nonprofit organizations receiving almost \$450 billion in contributions in 2019, one of the highest levels of giving on record. In inflation-adjusted dollars, individual giving increased 2.8% from 2019 to 2020, and corporate giving increased 11.4%. The pandemic impacted the timing of charitable giving during 2020, and many nonprofit organizations had to change their fundraising activities to move events online and increase the use of digital platforms for contributions. At the same time, many nonprofit organizations faced increased demand for their services that put pressure on their constrained resources. In response, some nonprofit organizations made difficult decisions to revise budgets, change procedures and work environments, reduce workforces, change service offerings, discontinue programs, and suspend operations. Remote working arrangements present additional challenges for technology, data and information security, cybersecurity risks, and internal controls.

Legislative and Regulatory Developments

This section of the Alert discusses the following topics in detail:

- Final regulations for unrelated business income silos.
- IRS refund procedures for the repeal of the "parking tax."
- Changes to Form 990-T.
- Final regulations for excise tax on excess remuneration.
- Final regulations for excise tax on net investment income.
- Changes to Form 941.

- Deductibility of charitable contributions under the CARES Act.
- Impact of PPP loan forgiveness on Form 990 Schedule A reporting.
- New Form 1099-NEC (Nonemployee Compensation).
- IRS quick response codes to allow taxpayers to access data.
- Matters affecting higher education, such as federal relief provided due to the COVID-19 pandemic, liquidity issues from reduced tuition revenues and higher COVID-19-related expenses and the impact on credit ratings and access to capital, the impact of new programs and additional funding to existing programs on SEFA reporting, compliance with the Graham-Leach-Bliley Act, and the U.S. Department of Education financial reporting supplemental schedule.

Audit and Attestation Issues and Developments

Auditors are reminded to consider the impact of economic, legislative, and regulatory developments on each unique nonprofit organization engagement. The Alert covers the following areas to consider this year:

- Audit risks for nonprofit organizations, including challenges of auditing in a COVID-19 environment: performing effective remote audits, understanding changes to internal controls and new fraud risks, auditing estimates and applying analytical procedures, auditing inventory and PPP loans, asset impairment, going concern, disclosures of risks and uncertainties.
- New auditing standards, including changes to the auditor's report, and the issuance of SAS No. 141, which amended the effective dates of SAS Nos. 134–140 to delay them by one year.
- New SAS on obtaining sufficient appropriate audit evidence.
- New SAS on auditor's responsibilities for accounting estimates, including fair value.
- New attestation standard for direct examination engagements.
- New attestation standard for review engagements.
- Release of the 2020 OMB Compliance Supplement and the Addendum to the 2020 Supplement.

Accounting Issues and Developments

This section of the Alert discusses the following topics in detail:

- Accounting for PPP loans and loan forgiveness.
- Disclosure of risks and uncertainties arising from the COVID-19 pandemic.
- Accounting considerations for nonprofit business combinations.
- FASB delay of effective dates for leases and revenue.
- FASB's lease update.

- FASB's revenue from contracts with customers update.
- FASB's guidance for contributions received and contributions made.
- FASB's new standard for presentation and disclosures of gifts-in-kind.
- FASB's reference rate reform.
- Valuation of interest rate swaps.
- Corrections to classification of net assets.
- Reporting equity transfers when a nonprofit organization receives services from an affiliate at no charge.

Other Items

Other items discussed in the Alert include recent pronouncements; recent AICPA Technical Questions and Answers; recent AICPA independence and ethics developments; AICPA nonprofit initiatives; other projects on the horizon and in the pipeline; and other online or print and internet resources.



GAO Issues COVID-19 Recommendations

The GAO issued two COVID-19 reports containing recommendations to the OMB that may be of interest.

COVID-19 Awards Audit Guidance

The first article, *COVID-19: Sustained Federal Action Is Crucial as Pandemic Enters Its Second Year*, addresses the lack of timely and relevant guidance from the OMB surrounding the audit requirements of new and existing COVID-19 federal awards.

GAO's recommendation to the OMB states that they should work with federal agencies and the audit community to "incorporate appropriate measures in the OMB process for preparing single audit guidance, including the annual Single Audit Compliance Supplement, to better ensure that such guidance is issued in a timely manner and is responsive to users' input and needs." Although the report, and this recommendation, were issued in light of the COVID-19 pandemic, the AICPA Government Audit Quality Center has been raising concerns surrounding the lack of timeliness, transparency, quality, and content of the Compliance Supplement for several years.

The report also noted that although single audit extensions provided in response to COVID-19 were helpful, the delay in issuing relevant guidance "could impact award recipients' development of corrective action plans, management decisions, and resolution of findings identified during the audits."

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COVID-19 Lessons Learned

As its title suggests, the second article, *OMB Should Collect and Share Lessons Learned from Use of COVID-19-Related Grant Flexibilities*, recommends that OMB collect and share lessons learned from the flexibilities that they granted to grantees (as well as auditors in the form of submission deadline extensions) in response to COVID-19. The report outlines 15 specific OMB-identified grant flexibilities related to COVID-19, such as no-cost extensions, procurement exemptions, and single audit extensions. The report states that “the collecting and sharing of lessons learned from previous programs or projects provides organizations with a powerful method for sharing ideas for improving work processes.” The recommendation aims to improve flexibilities, reduce administrative burden, and maintain accountability for federal funds.

Practical Consideration:

The reports can be accessed at the following links:

- COVID-19: Sustained Federal Action Is Crucial as Pandemic Enters Its Second Year: www.gao.gov/assets/gao-21-387.pdf.
- OMB Should Collect and Share Lessons Learned from Use of COVID-19-Related Grant Flexibilities: www.gao.gov/assets/gao-21-318.pdf.

Auditing Brief

OMB COMPLIANCE SUPPLEMENT AND AICPA AUDIT GUIDE STATUS. With continuing issues relating to federal funding and the COVID-19 pandemic, it is not surprising that we have yet to see the Office of Management and Budget’s 2021 Compliance Supplement. While at least parts of the 2021 Compliance Supplement are in the clearance process at OMB, it appears that the end of July is the most positive projection on when the Compliance Supplement will be released. However, an August release date may be a better bet! We are hearing different information on whether there will be an initial 2021 Compliance Supplement followed by one or more addenda—or perhaps the agencies will be responsible for providing additional information after the 2021 Compliance Supplement is released. We’ll update you on the Compliance Supplement’s contents when it is released. In the meantime, you can check for the new Compliance Supplement at www.whitehouse.gov/omb/management/office-federal-financial-management/.

The AICPA’s 2021 update of its audit guide, *Government Auditing Standards and Single Audits* (GAS/SA Guide) is also delayed. AICPA staff have indicated the GAS/SA Guide should be released in late August or early September. We’ll update you on the GAS/SA Guide’s contents when it is released.

