

THE PPC NONPROFIT UPDATE

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Mandatory E-filing Effective Dates



The September 2019 edition of this newsletter provided guidance on the new mandatory e-filing requirements for exempt organizations (EOs) and the related transitional relief for smaller organizations.

Recently the IRS issued News Release 2019-206, reminding EOs of these filing requirements that apply for tax years beginning after July 1, 2019. The following forms are required to be e-filed as indicated:

- Form 990 (Return of Organization Exempt from Income Tax) and Form 990-PF [Return of Private Foundation or Section 4947(a)(1) Trust Treated as Private Foundation] for years ending on or after July 31, 2020, must be filed electronically. For short years and other circumstances described in the form instructions, the IRS will continue to accept paper filings until their systems can receive the electronically submitted forms.
- Form 8872 [Political Organization Report of Contributions and Expenditures] filed by Section 527 organizations for reporting periods

(including monthly, quarterly, and semi-annual) after 2019 must be submitted electronically.

- Form 1065 (U.S. Return of Partnership Income) if filed by a Section 501(d) apostolic organization must generally be filed electronically if due on or after October 15, 2020 (i.e., the 15th day of the third month following a July 31 year-end).
- Form 990-EZ (Short Form Return of Organization Exempt from Income Tax) mandated e-filing has been delayed one year. For tax years ending on and before July 31, 2020, the IRS will accept either paper or electronic filing of Form 990-EZ. For tax years ending August 31, 2020, and later, Form 990-EZ must be filed electronically.
- Form 990-T (Exempt Organization Business Income Tax Return) and Form 4720 (Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code) will be accepted in paper format in 2020. The IRS plans to have these returns ready for e-filing in 2021 (for reporting tax year 2020).

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New Legislation Affecting Exempt Organizations

Disaster Act

The Taxpayer Certainty and Disaster Tax Relief Act of 2019 (Disaster Act) was enacted on December 20, 2019, as part of the Further Consolidated Appropriations Act, 2020 (P.L. 116-94). While the Disaster Act primarily extends previously expired legislation through 2020, it also contains other provisions directly impacting exempt organizations (EOs).

Parking Tax Repealed. As discussed in the April 2018 and February 2019 editions of this newsletter, the 2017 Tax Cuts and Jobs Act required tax-exempt organizations to increase their unrelated business taxable income (UBTI) by qualified transportation fringe benefits that were not associated with an unrelated trade or business (i.e., the “parking tax”) [IRC Sec. 512(a)(7)]. Thankfully, Section 302 of the Disaster Act permanently repeals the parking tax back to the date of its enactment—so never mind about that nasty provision!

Practical Consideration:

Organizations that paid tax on these fringe benefits may file an amended return for a tax refund.

Filing Deadlines Extended. Section 205 of the Disaster Act provides an automatic 60-day extension with regard to any tax filing for any qualified taxpayer [IRC Sec. 7508A(d)]. A qualified taxpayer includes a taxpayer with a principal place of business in a disaster area, as well as a taxpayer whose records necessary to meet a filing deadline are maintained in a disaster area. A disaster area is defined as an area warranting federal assistance under IRC Sec. 165(i)(5). This provision applies to federally declared disasters declared after December 20, 2019.

Decreased Excise Tax Rate on Private Foundation Investment Income. Section 206 of the Disaster Act decreases the Section 4940 tax incurred by private foundations on investment income from 2% to 1.39% and eliminates the reduced rate (i.e., 1%) for foundations meeting certain distribution requirements. These amendments apply to tax years beginning after December 20, 2019.

SECURE Act

The Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019 primarily affects retirement and savings plans, which are beyond the scope of this newsletter. However, as with most tax legislation, there are some “other provisions” contained in the SECURE Act that could directly impact exempt organizations.

Note: Like the Disaster Act, the SECURE Act was included as part of the Further Consolidated Appropriations Act, 2020.

Increased Failure to File Penalty. Under IRC Sec. 6651(a), a return filed more than 60 days after the due date is subject to a failure to file penalty unless the failure is due to reasonable cause. For returns due (including extensions) after December 31, 2019, Section 402 of the SECURE Act increases the failure to file penalty to the lesser of \$435 (adjusted for inflation) or 100% of the amount of the tax due.

Small Employer Plan Start-up Costs. Qualified startup costs of an eligible small employer’s new qualified pension plan may be eligible for the Section 45E small employer pension plan startup credit if the plan covers at least one non-highly compensated employee. For tax years beginning after December 31, 2019, the SECURE Act increases the credit by changing the calculation of the flat dollar amount limit on the credit. The credit is now calculated as the greater of: (1) \$500 or (2) the lesser of (a) \$250 multiplied by the number of non-highly compensated employees eligible to participate in the eligible employer’s plan or (b) \$5,000. The credit applies for up to three years [IRC Sec. 45E(b)(1)].



Final Regulation Released

The IRS has issued final regulations (T.D. 9886; Reg. 1.512-5) on how voluntary employee beneficiary associations (VEBAs) and supplemental unemployment benefit trusts (SUBs) must calculate unrelated business taxable income (UBTI).

Background

Special rules for calculating UBTI apply to organizations described in IRC Sec. 501(c)(7) (social and recreational clubs), voluntary employee beneficiary associations (VEBAs) described in IRC Sec. 501(c)(9), and supplemental unemployment benefit trusts (SUBs)

described in IRC Sec. 501(c)(17). For these organizations, UBTI is gross income, less directly connected expenses, but excluding *exempt function income*.

Exempt function income is gross income from dues, fees, charges, or similar amounts paid by members for goods, facilities, or services (for themselves, dependents, or guests) that further the entity's exempt function [IRC Sec. 512(a)(3)(B)].

Set-aside Income. Social clubs, VEBAs, and SUBs are permitted to set aside income for the following uses, and have it treated as exempt function income (i.e., not subject to tax) [IRC Sec. 512(a)(3)(B)]:

1. Religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.
2. Payment of life, health, or accident insurance, or other benefits [but only if the organization is a VEBA or SUB, and certain funding limits in IRC Sec. 512(a)(3)(E) are followed].
3. Reasonable administration costs directly attributable to items described in 1 or 2.

Income may not be set aside if derived from an unrelated trade or business regularly carried on by the organization. The amount a VEBA or SUB may set aside is limited to the amount that is actuarially calculated to be needed to fund the plan's liabilities for future claims, plus a reserve for post-retirement medical and life insurance benefits (the account limit) [IRC Secs. 512(a)(3)(E) and 419A]. Temp. Reg. 1.512(a)-5T provided that the VEBA or SUB would recognize UBI to the extent that the total amount set aside exceeded the account limit (without regard to the reserve for post-retirement benefits), but not to exceed the organization's income for the year (excluding contributions from members). The IRS took the position that the excess is UBI regardless of whether income was used to pay benefits or reasonable administrative costs during the year.

When Temp. Reg. 1.512(a)-5T was published in 1986, proposed regulations were contemporaneously released. These proposed regulations were later withdrawn. In 2014, a new proposed regulation was published. The Treasury Department and the IRS have considered the comments received in response to the 2014 proposed regulation and have now issued a final regulation adopting the provisions of the 2014 proposed regulation with minor modifications. The temporary regulation [Temp. Reg. 1.512(a)-5T] is removed.

Note: Section 501(c)(7) organizations are also subject to the UBTI computation rules of IRC Sec. 512(a)(3); however, this regulation addresses only computations for VEBAs and SUBs.

What Changed in the Final Regulation

The final regulation adopts the provisions of the 2014 proposed regulation with minor modifications:

1. A change in the applicability date to tax years beginning on or after December 10, 2019.
2. A modification and clarification of the definition of *covered entity*.
3. The addition of a clause addressing nonrecognition of gain for sales of certain property.
4. Updates to the examples, formatting changes, and other nonsubstantive wording changes.

Covered entity. The final regulation uses the uniform term *covered entity* to describe VEBAs and SUBs subject to the UBTI computations under IRC Sec. 512(a)(3). A group legal service organization (GLSO) is no longer a covered entity. Additionally, a clause clarifies that a covered entity includes a corporation described in IRC Sec. 501(c)(2) (organized to hold title to property), and is treated as having exempt function income only if it files a consolidated return with the organization as provided in IRC Sec. 512(a)(3)(C).

Nonrecognition of gain. The final regulation, adding a clause referring to the provision of IRC Sec. 512(a)(3)(D), provides for the nonrecognition of gain in certain circumstances. If property used directly in performing an exempt function of a covered entity is sold and replaced with other property purchased and used directly by the covered entity in performing an exempt function within a certain period, the gain (if any) from the sale is recognized only to the extent that the sales price of the old property exceeds the cost of purchasing the other property. The other property (i.e., replacement property) must be purchased and used within a four-year period beginning one year before the date of the sale and ending three years after the date of sale.

Clearing up a conflict in the courts. Certain taxpayers have followed the *Sherwin-Williams* [91 AFTR 2d 2003-2302, 6th Cir. (2003)] decision and asserted that investment income may be set aside and used separately before the end of the tax year (for current benefit payments and related administrative costs) and avoid the limit imposed by IRC Sec. 512(a)(3)(E)(i) on exempt function income. The Treasury Department and the IRS have concluded that the *Sherwin-Williams* decision is contrary to statute, legislative history, Temp. Reg. 1.512(a)-5T, and the previously-issued proposed regulations. This final regulation clarifies that all investment income earned during the year should be considered in determining whether there is an account overage.



AICPA Website NFP Resources

The Not-for-Profit interest area page of the AICPA website can be found at www.aicpa.org/interestareas/notforprofit.html. From this page, users can explore resources specific to nonprofit organizations, such as information about AICPA not-for-profit section membership; CPE and events, such as upcoming and archived webcasts and upcoming conferences; not-for-profit industry news; and open access resources. Some of that content is locked and available only to AICPA Not-for-Profit Section members. However, there are several resources that are freely available to non-Section members. In this issue, we'll explore some of that content.

NFP Industry News

The not-for-profit industry news category includes links to the most recent articles from the AICPA's *Journal of Accountancy* and links to the Internal Revenue Service's videos on various exempt organization topics.

Practical Consideration:

The *Journal of Accountancy* archive of articles relevant to Tax Exempt Organizations is available at www.journalofaccountancy.com/topics/tax/tax-exempt-organizations.html.

Open Access Resources

On the main not-for-profit interest area page, there is a list of over twenty items that are freely available to non-Section members.

NFP Resource Library

The NFP Resource Library presents information covering four topical areas: Financial Accounting & Reporting, Assurance, Tax Compliance, Governance & Management.

Within the Financial Accounting & Reporting and Assurance categories, you'll find a link to Quick Reads, which are short articles that are unlocked and available to non-Section members. Most of the freely available articles are listed in the open access resources list on the main interest area page, but many are not, such as "Underresourced and Sometimes Ignored: Key Reasons Your Nonprofit's Finance Function May Struggle" and "Taking the Mystery Out of Preparing a Statement of Cash Flows."

Similarly, within the Tax Compliance and the Governance & Management categories are links to various open access articles, in addition to those in the list of open access resources on the main not-for-profit interest area page.

Practical Consideration:

The NFP Resource Library is available at www.aicpa.org/interestareas/notforprofit/resources.html.

Not-for-profit FAQs

The AICPA not-for-profit resources include two separate lists of frequently asked questions (FAQs). The NFP Governance and Management FAQs present responses to 16 FAQs relating to nonprofit organizations. The FAQs and responses are separated in the following three topical areas: Board Activities, Financial Reporting, Other Considerations. In addition, the NFP Audit and Accounting FAQs present 12 FAQs about various accounting topics such as gifts-in-kind, net assets, and valuing donated time.

Practical Consideration:

NFP Governance and Management FAQs are available at www.aicpa.org/interestareas/notforprofit/resources/governancemanagement/governancemanagementfaqs.html. NFP Audit and Accounting FAQs are available at www.aicpa.org/interestareas/notforprofit/resources/financialaccounting/nfp-audit-and-accounting-faqs.html.

Not-for-profit Issues Survey

Near the bottom of the main interest area page is a survey posing a variety of not-for-profit-related questions. Take the survey or check the results. The content will cycle to the next survey question. It's a real-time way to gauge what your colleagues are thinking. The more participation, the better the results!



What Is Materiality?

In December 2019, the AICPA Auditing Standards Board (ASB) issued SAS 138, *Amendments to the Description of the Concept of Materiality*, as a parting gift for the decade. The ASB also issued SSAE 20, with the same title as SAS 138, concurrently.

What Changes?

The new SAS and SSAE change the definition of *materiality* so that it's more closely aligned with those of the United States judicial system, SEC, PCAOB, and Financial Accounting Standards Board. The new definition doesn't match any one definition exactly, but rather moves the definition closer to the definition currently used in practice by the various entities.

Practical Consideration:

The FASB defines materiality at SFAC 8, Chapter 3, paragraph 11, as "the omission or misstatement of an item in a financial report is material, if, in light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item."

Current Definitions. The extant definition from AU-C 320.02 is "misstatements, including omissions, are considered material if they, individually or in the aggregate, could reasonably be expected to use influence the economic decisions of users made on the basis of the financial statements." The extant definition at AT-C 205.A17 and AT-C 210.A16 is "misstatements, including omissions, are considered to be material if, individually or in the aggregate, they could reasonably be expected to influence relevant decisions of intended users that are made based on the subject matter." The extant definitions were consistent with those used by the International Accounting Standards Board and the International Auditing and Assurance Standards Board.

New Definitions. The amended definition at AU-C 320.02 is "misstatements, including omissions, are considered to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements." The amended definition at AT-C 205.A17 and AT-C 210.A16 is "misstatements, including omissions, are considered to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by intended users based on the subject matter."

Reasonable User. AU-C 320.04 includes assumptions the auditor may make about what determines a reasonable user. Those assumptions aren't substantially changed by SAS 138.

Other Literature Affected. SAS 138 also amends the discussion of materiality in other AU-C sections so that those discussions are consistent with the revised

definition. The standards affected are AU-C 200.07; AU-C 450.A23; AU-C 600.32 and .A63; AU-C 700.35 and .A14; and AU-C 703.74, .115, and .A69.

When Are the Changes Effective? SAS 138 is effective for audits of financial statements for periods ending on or after December 15, 2020. SSAE 20 is effective for practitioners' examination and review reports dated on or after December 15, 2020. The ASB doesn't believe that adoption of the new standards will change current practice.



SAS ED for AU-C 900 Series and Other Reporting Changes

In December 2019, the AICPA Auditing Standards Board (ASB) issued a proposed Statement on Auditing Standards (SAS), *Amendments to AU-C Sections 725 730, 930, 935, and 940*. The proposed SAS makes changes to conform AU-C 930, *Interim Financial Information*, AU-C 935, *Compliance Audits*, and AU-C 940, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*, with the requirements of SAS 134, *Auditor Reporting and Amendments, including Amendments Addressing Disclosures in the Audit of Financial Statements*, and makes changes in AU-C 725, *Supplementary Information in Relation to the Financial Statements as a Whole*, and AU-C 730, *Required Supplementary Information*, to reference a separate section in the auditor's report to be consistent with SAS 137, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*. The proposed SAS also reflects the amended requirements in SAS 138, *Amendments to the Description of the Concept of Materiality*.

AU-C 900 Series Changes

In May 2019, the ASB issued SAS 134, which will change the form and content of the auditor's report when implemented. The proposed SAS amends the requirements for auditor's reports in the circumstances specified by AU-C 930, 935, and 940 to conform to the requirements of SAS 134.

AU-C-930. The proposed changes to the reporting requirements in AU-C 930 include placing the auditor's review conclusion at the beginning of the review report on interim financial information. The proposed SAS will also revise the requirements for the dating of the review report.

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AU-C-935. In addition to the proposed amendments for the issuance of SAS 134 and 137, AU-C 935 has been revised for developments in the compliance area, including updating references to OMB's *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* and reflecting changes in the OMB Compliance Supplement and for the issuance of *Government Auditing Standards, 2018 Revision* (the 2018 Yellow Book). The proposed amendments change the presenting requirements for a combined report on compliance and internal control to be the default form of report, followed by requirements addressing when the auditor chooses to issue separate reports on compliance and on internal control over compliance. The ASB is reversing the presentation of the requirements because they believe combined reports are more common in practice. The proposed changes in AU-C 935 also include the revision of the definition of *material noncompliance* to align with the description of *materiality* in SAS 138.

AU-C-940. The proposed amendments to AU-C 940 revise the form and content of the auditor's report on internal control over financial reporting (ICFR) to also require the "Auditor's Responsibilities for the Audit of ICFR" section to include a statement that internal control over financial reporting is not effective if a material weakness exists. The proposed SAS includes referencing requirements when issuing a separate report on ICFR. Requirements are revised on reporting when there is a scope limitation. The proposed SAS also addresses situations when management includes additional information in management's report or in a document containing management's report and the related auditor's report.

Reference to a Separate Section of the Auditor's Report

In July 2019, the ASB issued SAS 137, which includes a requirement to reference to a separate section in the auditor's report rather than to an other-matter paragraph. AU-C 725 requires the auditor to report on supplementary information and AU-C 730 requires reporting on required supplementary information. Since supplementary information and required supplementary information are comparable to other information, the proposed SAS changes the requirements in AU-C 725 and 730 to refer a separate section in the auditor's report rather than an other-matter paragraph to be consistent with SAS 137.

Proposed Effective Dates

The exposure draft indicates the proposed amendments to:

- AU-C 725 and 730 will be effective for audits of financial statements for periods ending on or after December 15, 2020, with early implementation not permitted.
- AU-C 930 will be effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2020, with early implementation not permitted.
- AU-C 935 will be effective for compliance audits for fiscal periods ending on or after December 15, 2020, with early implementation not permitted.
- AU-C 940 will be effective for integrated audits for periods ending on or after December 15, 2020, with early implementation not permitted.

