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THE PPC
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The Impact of Consolidated Appropriations Act (2021) on Nonprofits

On December 27, 2020, President Trump signed the $2.3 trillion *Consolidated Appropriations Act, 2021* ("the Act") that includes roughly $900 billion in economic stimulus provisions. In addition to direct payments for individuals and expanded unemployment benefits, the Act contains several provisions that affect nonprofit organizations eligible for the Paycheck Protection Program (PPP) and Economic Injury Disaster Loans (EIDLs).

The COVID-Related Tax Relief provisions of the Act ("COVIDTRA") clarify the tax treatment of a PPP loan. Under general circumstances, an organization must report the discharge of indebtedness income in its gross taxable income. COVIDTRA clarifies that forgiveness of a PPP loan or an EIDL Advance is not included in an organization's gross income. Furthermore, organizations that spend PPP or EIDL advance proceeds on otherwise deductible expenses are permitted to deduct those expenses from taxable income even if the loan is forgiven. In other words, the receipt of PPP and EIDL funds is not included in taxable income even if forgiven, but the expenditure of the funds is deductible. In addition, the tax basis and other attributes of the borrower's assets will not be reduced as a result of PPP loan forgiveness and EIDL grants. The provision is effective retroactively to the date of enactment of the CARES Act and provides similar treatment for second draw PPP loans, described later.

Other provisions of the COVIDTRA include the following:

- Additional allowable expenses and forgivable uses for PPP funds retroactive to the start of the CARES Act, including expenditures for covered operations; certain property damage costs that occurred during 2020 but were not covered by insurance; essential supplies, including perishable supplies, purchased prior to taking out the loan; and worker protection expenditures.
- A simplified application process for loans under $150,000 that requires borrowers to submit a one-page certification describing the total loan amount, the estimated amount of the loan that was spent on payroll, and the number of employees retained because of the loan.
- Extension of the covered period for PPP loans from December 31, 2020, to March 31, 2021.

In this Issue:

- The Impact of Consolidated Appropriations Act (2021) on Nonprofits
- Using the Correct NAICS Code When "Siloing"
- Tax Briefs
- PPP Loan Accounting Issues
- Functional Expense Reporting—Reminders for Preparers and Auditors
- Auditing Brief

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- Clarification that employer-provided group life, disability, vision, and dental insurances are covered payroll costs for purposes of PPP forgiveness.
- A PPP "second draw" of up to $2 million for smaller and harder-hit non-publicly traded businesses in operation on February 15, 2020, with fewer than 300 employees (500 for certain organizations with multiple locations) and a 25% reduction in gross receipts in any quarter of 2020 compared to the same quarter in 2019.
- Clarification that churches and religious organizations principally engaged in teaching, instructing, counseling, or indoctrinating religion or religious beliefs are eligible for a PPP loan.
- Borrowers who returned all or part of a PPP loan without receiving forgiveness but who are likely to qualify for forgiveness under the modified requirements of the Paycheck Protection Program Flexibility Act can reapply for the maximum applicable amount.
- PPP eligibility for Section 511 public colleges and universities that have a public broadcasting station if the organization certifies that the loan will support locally-focused or emergency information.
- PPP eligibility for Section 501(c)(6) organizations (other than professional sports leagues and those with the purpose of participating in political activities) with 300 or fewer employees that receive 15% or less of receipts from lobbying, but only if lobbying activities comprise 15% or less of total activity and total lobbying costs did not exceed $1 million in the tax year ending on or before February 15, 2020.
- A prohibition on using proceeds of a covered loan for lobbying activities (as defined by the Lobbying Disclosure Act rather than the Internal Revenue Code), lobbying expenditures related to state or local campaigns, or expenditures to influence the enactment of the legislation, appropriations, or regulations.
- $15 billion for eligible live venue operators or promoters, theatrical producers, live performing arts organization operators, museum operators, motion picture theater operators, or talent representatives who demonstrate a 25% reduction in revenues.
- Repeal of the EIDL Advance Deduction, which required borrowers to reduce their PPP loan forgiveness amount by the amount of their EIDL advance (as distinguished from an EIDL loan, which remains ineligible for forgiveness).
- Extension of certain charitable donation incentives included in the CARES Act, such as raising the normal AGI limits for cash contributions made to qualified public charities in calendar year 2020, allowing non-itemizers to claim an "above-the-line" deduction for charitable contributions made in calendar year 2020, and raising the non-itemizer deduction to $600 for married-filing-jointly taxpayers, through calendar year 2021.
- 100% deductibility of food and beverage expenditures that qualify as ordinary and necessary business expenses and that are incurred in 2021 and 2022 (not 2020) if provided by a restaurant, whether eaten on the restaurant's premises or ordered for takeout or delivery, although all other ordinary and necessary business food and beverage expenses remain 50% deductible and entertainment expenses remain nondeductible.
- Additional time to repay deferred payroll taxes. Since September 1, 2020, the IRS has permitted an employer to defer withholding of the employees' share of Social Security tax on certain wages through December 31, 2020 (IRS Notice 2020-65, 2020-38 IRB 567). The deferred amounts were required to be repaid through increased withholding between January 1, 2021, and April 30, 2021. COVIDTRA allows the deferred tax to be repaid through December 31, 2021.
- Extension of the employee retention tax credit through June 30, 2021. The credit rate for the first two quarters of 2021 increases from 50% to 70%, and the wage limit is raised from $10,000/year to $10,000/quarter. The maximum credit is $5,000/employee in 2020 and $14,000/employee in 2021. The refundable credit is available to an employer when its gross receipts fall by 20% rather than the previous 50%. Employers that receive PPP loans may claim the credit only for wages not paid with forgiven PPP loan proceeds.

Using the Correct NAICS Code When "Siloing"

When identifying separate unrelated trades or businesses, the organization should select the two-digit NAICS code that most accurately describes the unrelated activity, not the exempt purpose. For example, a social club that earns nonmember revenue from operating a golf course and a restaurant should not use the codes for the exempt activity (operating a golf course or a country club), but instead should use codes that describe the sale of merchandise, food, and beverages. An exempt organization that changes its two-digit NAICS code identifying an unrelated trade or business must report the change in the tax year of the change. The organization must provide—

- the identification of the separate unrelated trade or business in the previous tax year,
- the identification of the separate unrelated trade or business in the current tax year, and
- the reason for the change.

Reasons for changing the two-digit NAICS code include partnership interests that no longer meet the requirements to be treated as a qualifying partnership interests (QPI) and the improper combination of various activities.

The transition from the use of six-digit NAICS codes to two-digit NAICS codes is generally not a code change if the first two digits of the six-digit code match the two digits of the two-digit code. For example, various forms of advertising, such as periodicals, websites, convention programs, and direct mail, have different six-digit NAICS codes and therefore may have been treated as separate trades or businesses in a prior year. However, they all use the same two-digit NAICS code and therefore are a single trade or business. An exempt organization may amend prior returns to combine trades or businesses and their associated net operating loss (NOL) carryforwards using two-digit NAICS codes. However, an NOL attributable to a trade or business that changes to a different two-digit NAICS code is suspended and can only be used when a future activity utilizes the original NAICS code, unless the organization can establish that the previous code was used in error and that there has been no material change in the unrelated trade or business.

Certain separate unrelated trades or businesses do not report NAICS codes, including income from a controlled subsidiary, investment activities, certain amounts derived from a controlled foreign corporation, and nonqualified interests in an S corporation. The IRS 2020 Instructions for Form 990-T provide a list of Non-NAICS Business Activity Codes. Payments of interest, annuities, royalties, and rent from a controlled entity are a separate unrelated trade or business to the extent that they reduce the net taxable income (or increases the net taxable loss) of the controlled entity. All these payments received from a single controlled entity are aggregated and reported as a single separate unrelated trade or business using the Non-NAICS Business Activity Code 903001. If an organization receives these payments from more than one controlled entity, then the payments from each additional controlled entity are reported as a separate trade or business using the Non-NAICS Business Activity Code 903002, 903003, etc. The income is not combined with other investment or rental income.

All unrelated business income from debt-financed property is grouped together as a single unrelated trade or business using the Non-NAICS Business Activity Code 901101. Rent from debt-financed property is not combined with rental income from personal property or rental income from a controlled subsidiary.

Certain organizations such as social clubs and VEBAs that are taxed on gross income other than exempt function income should use Non-NAICS Business Activity Code 901101. Taxable interest, annuities, royalties, and rent are combined and reported as a single separate trade or business. The taxable rent income of a social club is not combined with other taxable rent income it may have, such as rent income from debt-financed property or rent income from a controlled subsidiary.

Tax Briefs

CARES ACT INCREASE IN CHARITABLE DEDUCTION DOES NOT APPLY FOR UBIT. The CARES Act increased the charitable contribution deduction limit for corporations for cash contributions made during calendar year 2020 to qualifying organizations from 10% to 25% of taxable income. COVIDTRA extends this provision through calendar year 2021. However, IRC Sec. 512(b)(10) was not amended, so exempt organizations must use the 10% limit specified in IRC Sec. 512(b)(1), not the 25% limit, when deducting charitable donations from unrelated business taxable income.

2021 STANDARD MILEAGE RATE. Beginning January 1, 2021, the standard mileage rates used to calculate the deductible costs of operating an automobile are (Notice 2021-2)—

- 56 cents per mile driven for business use, down 1.5 cents from the rate for 2020,
- 16 cents per mile driven for medical, or moving purposes for qualified active duty members of the Armed Forces, down 1 cent from the rate for 2020, and
- 14 cents per mile driven in service of charitable organizations, the rate is set by statute and remains unchanged from 2020.

ELECTRONIC FILING OF FORM 4720 DELAYED. Notice 2021-1 (2021-2 IRB 315) delays the application of IRC Sec. 6033(n) requiring private foundations to electronically file Form 4720 (Return of Certain Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code). Initially, if a private foundation is liable for the tax imposed under Chapter 42, it must file Form 4720 to provide to the IRS the information required by IRC Sec. 6033 and Reg. 1.6033-2(a)(2)(ii)(J). The Taxpayer First Act of 2019 amended IRC Sec. 6033(n) to provide that any tax-exempt organization required to file a return under IRC Sec. 6033 must file the return electronically. Form 4720 filed by a private foundation as part of the Form 990-PF is required to be electronically filed as a return required under IRC Sec. 6033(n). Private foundations may continue to file the paper version of Form 4720 until electronic filing is available, which is expected in early 2021. In addition, under Reg. 53.6011-1(c), disqualified persons of the private foundation are allowed to paper file a joint Form 4720 to comply with the filing requirement under Reg. 53.6011-1(b), provided all persons share the same tax year. However, once Form 4720 is required to be filed electronically, the disqualified persons must file separate Forms 4720. The IRS system allows for only one taxpayer per return.

PPP Loan Accounting Issues

Paycheck Protection Program (PPP) loans present many challenges for nonprofit organizations. Here are some accounting challenges to be aware of for year-end reporting.

Loan Forgiveness

The AICPA issued Technical Question and Answer (TQA) 3200.18 in June 2020 on how nongovernmental entities, including nonprofit and business entities, can account for forgivable loans received under the PPP. Although the legal form of the loan is debt, it may be considered a government grant in substance if certain conditions are met.

If an organization has no plan to request forgiveness of the PPP loan, or if the borrower cannot support that it will probably meet both eligibility and forgiveness criteria, the funds received should be accounted for as debt under FASB ASC 470, *Debt*. Under FASB ASC 470, when the proceeds are received, the loan amount is recorded as a liability and interest is recorded at 1% over the loan term using the interest method.

The loan proceeds remain recorded as a liability, based on guidance in FASB ASC 405-20, until either the loan is forgiven and the debtor has been legally released (in whole or in part), or the loan is paid off. If forgiven and released, the liability is reduced and a gain on extinguishment is recorded based on FASB ASC 450-30 for gain contingencies for the amount of debt forgiven, including accrued and unpaid interest and any unamortized deferred financing costs on the forgiven portion.

Under the program, borrowers must submit an application for forgiveness to the creditor, who then issues a recommendation to the Small Business Administration (SBA), and then the SBA has 90 days to review the request. A PPP loan is considered forgiven only after the SBA has determined the amount that is eligible for forgiveness and has notified the lender, who should notify the borrower.

If a nonprofit organization plans to pursue forgiveness and it is probable it meets the PPP eligibility and loan forgiveness criteria, it may account for the PPP loan as a government grant/conditional contribution under FASB ASC 958-605, *Not-for-Profit Entities—Revenue Recognition*. The loan is recorded when the cash is received as a refundable advance that would be reduced, with the conditional contribution recognized as income, once the conditions for loan forgiveness have been substantially met or explicitly waived. These conditions include incurring qualifying expenditures and maintaining the required employee and salary levels under the program.

For nonprofit organizations with calendar year-ends, the loan forgiveness will likely occur in the same year as the "covered period." However, organizations that have calendar year-ends of June 30, July 31, or August 31 may likely have any loan forgiveness occur in the fiscal year after the covered period, and their covered period may be in two different fiscal years. This can potentially affect other legal compliance issues, including cost reimbursements under federal awards.

Under either of these two accounting approaches, borrowers should disclose in the notes to the financial statements their accounting policy for the PPP loan and how it is presented in the financial statements, including any forgiveness in the period, along with meeting other disclosure requirements of FASB ASC 470 or FASB ASC 958-605, as applicable.

No Double-dipping

Nonprofit organizations are not permitted to "double-dip," by being reimbursed twice as a result of using the same expenses for PPP loan forgiveness and obtaining expense or cost reimbursements under other federal, state, and local government programs and contracts or private grants.

The PPP guidance does not address double-dipping, so it is important to read other government guidance and grant agreements to be aware of restrictions on being reimbursed twice for the same expense. It is also important to track costs to make sure they are not applied more than once. Some advisors recommend organizations have separate general ledger accounts to separate those expenses paid with PPP funds from those expenses paid with other government money to help ensure that "double-dipping" does not occur.

Practical Consideration:

The TQA is available on Checkpoint or on the AICPA's website at **www.aicpa.org/content/dam/aicpa/interestareas/frc/downloadabledocuments/tqa-sections/tqa-section-3200-18.pdf**. The SBA has an FAQ on PPP Loan Forgiveness at **www.sba.gov/sites/default/files/2020-08/PPP%20Loan%20Forgiveness%20FAQs%208-4-20.pdf**.

Functional Expense Reporting—Reminders for Preparers and Auditors

Now that all nonprofit organizations have implemented ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*, they must report expenses by both nature and function (purpose). Organizations also must disclose the methods used to allocate costs among program and support functions. During our review of financial statements during the past year, we've noticed several instances where nonprofit organizations weren't quite meeting all the requirements. Here's a refresher on the requirements.

Practical Consideration:

Each year, as part of our preparation of *PPC's Nonprofit Financial Statement Illustrations and Trends* (NPT), we review financial statements received from firms and nonprofit organizations from all over the country. For more information about NPT, go to **tax.thomsonreuters.com**.

Financial Statement Presentation Requirements

FASB ASC 958-205 requires all nonprofit organizations to report information about all expenses in one location—either on the face of the statement of activities, in a schedule in the notes to the financial statements, or in a separate financial statement. Organizations must report expenses by both their functional and natural classification. For all expenses, the reported information must present the relationship between the functional classification and the natural classification in an analysis that disaggregates the functional expenses (major classes of program services and supporting activities) by their natural expense classification (like salaries and rent). The reported information also presents expenses reported by other than natural classification (like salaries included in cost of goods sold) by natural classification in the functional expense analysis.

External and direct internal investment expenses are the exception to this requirement. According to FASB ASC 958-220-45-14, nonprofit organizations are to report investment return net of external and direct internal investment expenses. Those expenses aren't included in the functional allocation.

Note that the requirements apply only to expenses. Losses aren't considered expenses.

Allocation Methods

Organizations must allocate expenses that relate to more than one program or supporting activity to the various programs or supporting activities. After initial implementation of ASU 2016-14, it's important to ensure that the nonprofit organization continues to allocate all expenses to the correct functional category. The organization may have initially allocated an expense to a specific functional category. But, over time, if the nature of the organization's activities related to that expense change, the organization may need to revise the functional expense category used. The organization must apply the allocation method consistently over reporting periods under similar facts and circumstances and thus may need to update the allocation method as facts and circumstances change.

Many nonprofit organizations have made significant changes to their operations in response to COVID-19, and these changes may require a review of all current classifications and allocation methods. For example, private school teachers now helping to solicit contributions would have some portion of their time reported as fund-raising (a supporting service) instead of education (a program service). Or, if a director of fundraising is also providing programming, there would need to be a change in allocation of the director's salary and benefits.

Practical Consideration:

The AICPA's Not-for-Profit Section (**https://future.aicpa.org/topic/not-for-profit**) includes information on functional expenses and other nonprofit accounting and reporting topics. The AICPA has made access to parts of the Section available to the general public and other parts available to members only.

Peer Review Findings and Audit Procedures

Functional expense reporting can be a challenging area for nonprofit organizations. Inadequate audit procedures to support the audit opinion was a common area of deficiencies for nonprofit organization audits noted during peer reviews. Specifically, the AICPA Professional Ethics Division December 31, 2019, report, *Common deficiencies: Government and not-for-profit audits*, noted a common peer review deficiency was financial statements of nonprofit organizations failing to report expenses by their functional classification, such as major classes of program services.

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When obtaining an understanding of the entity and assessing the risk of material misstatement, the auditor needs to consider the organization's controls around properly allocating and reporting expenses in the financial statements. Failure to monitor and update expense models and allocation processes could result in potential misstatement of the financial statements. Thus, if a nonprofit organization audit client has had significant changes in its activities and hasn't considered the impact on its functional expense reporting, the auditor needs to consider the appropriate audit response.

Practical Consideration:

The practice aids in *PPC's Guide to Audits of Nonprofit Organizations* include places to document obtaining an understanding of the client and identifying risks. Also, the practice aids allow the auditor to assess those risks and appropriately tailor the audit plan to address any risks related to reporting expenses.

Auditing Brief

ADDENDUM TO THE 2020 COMPLIANCE SUPPLEMENT RELEASED. On December 22, 2020, the Office of Management and Budget (OMB) released the Addendum to the 2020 OMB *Compliance Supplement*. As expected, it includes compliance requirements for several new COVID-19-related programs and existing programs affected by COVID-19. It also includes one new non-COVID-19 cluster. Among other provisions, it provides a three-month audit submission extension for audits of entities receiving COVID-19 funding; important new information about when the Provider Relief Fund program (PRF) section (Assistance Listing 93.498) expenditures and lost revenues should be included on the schedule of expenditures of federal awards (SEFA); a new footnote on the SEFA about donated personal protective equipment (PPE); and additional reporting compliance requirements for certain programs. The next issue of this newsletter will discuss details about the Compliance Supplement Addendum. You should carefully read the Addendum, which can be accessed at **www.whitehouse.gov/omb/management/office-federal-financial-management/**.