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FASB Standards: What's Up Next to Implement for Nonprofit Organizations

The FASB issued a number of ASUs in 2020. Below is a summary of the 2020 ASUs that are most relevant to nonprofit organizations. In addition, certain ASUs issued before 2020 that are effective for 2020–2021 financial statements are highlighted.

New ASUs

The following paragraphs highlight several ASUs issued in 2020 that will affect nonprofit organizations.

ASU 2020-01, *Investments—Equity Securities (Topic 321), Investments—Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815): Clarifying the Interactions between Topic 321, Topic 323, and Topic 815* (a consensus of the FASB Emerging Issues Task Force). The amendments clarify the interaction of the accounting for equity securities under Topic 321, equity method investments under Topic 323, and certain forward contracts and purchased options under Topic 815. For all entities other than public business entities, the amendments are effective for fiscal years beginning after December 15, 2021, and interim periods within those fiscal years. The amendments should be applied prospectively, and early adoption is permitted.

ASU 2020-04, *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting*. Initiatives to reform global reference rates will result in alternative reference rates that will replace LIBOR and other commonly used benchmark interest rates. The FASB issued this optional guidance to provide relief in accounting for contract modifications related to transitioning from LIBOR and other reference rates for a limited period of time. If certain criteria are met, qualifying entities have the option to apply expedients and exceptions in accounting for contract modifications (receivables, debt, and leases) and hedging relationships that reference discontinued rates. If the expedient is elected, it must be applied to all eligible contract modifications. This ASU may be applied any time after March 12, 2020, but no later than December 31,

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2022, which is the rate reform transition period.

ASU 2020-05, *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities.* The FASB deferred the effective dates of these Topics by one year to provide relief as a result of the COVID-19 pandemic for all entities who have not issued their financial statements (or made them available for issuance) as of June 3, 2020. Topic 606 is now effective for private nonprofit entities for annual reporting periods beginning after December 15, 2019, and for interim reporting periods within annual reporting periods beginning after December 15, 2020. These entities may elect to adopt Topic 606 based on previous guidance. Topic 842 is now effective for private nonprofit entities for fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022. For public nonprofit entities that have not yet issued their financial statements (or made them available for issuance) reflecting the adoption of Topic 842, it is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption continues to be permitted. Nonprofit entities that already issued their financial statements or are conduit bond obligors for publicly traded securities are not affected by these amendments. The ASU is effective upon issuance.

ASU 2020-07, *Not-for-Profit Entities (Topic 958): Presentation and Disclosures by Not-for-Profit Entities for Contributed Nonfinancial Assets.* The ASU includes new requirements for presentation and disclosure of contributed nonfinancial assets (gifts-in-kind). The ASU's intent is to provide more transparency about the measurement and use of nonfinancial assets. It requires gifts-in-kind to be presented as a separate line in the statement of activities. It also requires additional disclosures in the notes to the financial statements, including disaggregation into categories based on the type of gift received, and qualitative disclosures for each category of asset. The amendments are effective for annual periods beginning after June 15, 2021, and interim periods within annual periods beginning after June 15, 2022. Early adoption is permitted. The amendments should be applied on a retrospective basis to all periods presented. For additional information, see the December 2020 issue of *The PPC Nonprofit Update*.

New ASUs—Codification Improvements

The FASB has a standing project on its agenda to make improvements to GAAP, address suggestions and feedback from stakeholders, and update standards for technical corrections and clarifications. The following Codification Improvements ASUs were issued in 2020.

ASU 2020-08, *Codification Improvements to Subtopic 310-20, Receivables—Nonrefundable Fees and Other Costs.* The amendments in this ASU clarify guidance in ASU 2017-08, *Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20)*, about amortization periods for premiums on callable debt securities and indicate that entities should reevaluate whether a callable debt security with multiple call dates is within the scope of FASB ASC 310-20-35-33 for each reporting period. For entities other than public business entities, the amendments are effective for fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022, with early application permitted for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. The amendments should be applied prospectively as of the beginning of the period of adoption for existing or newly purchased callable debt securities.

ASU 2020-03, *Codification Improvements to Financial Instruments.* The amendments in this ASU are intended to clarify and improve certain accounting and disclosure guidance in a number of financial instrument Topics in the Codification. They apply to all reporting entities within the scope of the affected accounting guidance. See the ASU for further information about and effective dates of the improvements made.

ASU 2020-10, *Codification Improvements.* The amendments in this ASU affect a number of Topics in the Codification. They do not change GAAP, but they apply to all reporting entities within the scope of the affected accounting guidance. The amendments in Sections B and C of the ASU are effective for entities other than public business entities for annual periods beginning after December 15, 2021, and interim periods within annual periods beginning after December 15, 2022, and early application is permitted for any annual or interim period for which financial statements are available to be issued. The amendments should be applied retrospectively at the beginning of the period that includes the adoption date.

Highlights of Certain Previously Issued ASUs Becoming Effective for 2020–2021 Financial Statements

As a reminder, the following paragraphs highlight certain ASUs that were issued before 2020 but become effective for 2020–2021 financial statements.

ASU 2019-03, *Not -for-Profit Entities (Topic 958): Updating the Definition of Collections.* with the one used by the American Alliance of Museums. It intends to reduce diversity in accounting practice. The ASU also requires disclosure of the organization's policy for use of proceeds from collection items that are removed from a collection (deaccessioned). If a collection-holding organization has a policy allowing the proceeds to be used for direct care, it should disclose its definition of direct care. The ASU is effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020, with early adoption permitted. The amendments apply to all entities that maintain collections and should be applied on a prospective basis.

ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement.* ASU-2018-03 requires significant changes for all entities to disclosures for Level 3 investments, and changes to disclosures for transfers between Level 1 and Level 2 investments and investments in certain entities that calculate net asset value. The ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, with early adoption permitted. Certain disclosures must be applied prospectively, with others to be applied retrospectively to all periods presented.

ASU 2018-08, *Not-For-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made.* ASU 2018-08 was issued to reduce diversity in practice in accounting for recognition of grants and contracts. The ASU provides clarifications on evaluating whether a transaction should be accounted for as a contribution or exchange transaction and an improved framework for determining whether contributions are conditional or unconditional. The ASU also provides guidance to distinguish donor-imposed conditions from restrictions. For entities other than public business entities, amendments for resource recipients (contributions received) should be applied to transactions in annual periods beginning after December 15, 2018, and interim periods beginning after December 15, 2019. For resource providers (contributions made), the amendments should be applied to annual periods beginning after December 15, 2019, and interim periods within annual periods beginning after December 15, 2020. Early adoption is permitted.

Practical Consideration:

The ASUs are available at **www.fasb.org** and on Checkpoint at **checkpoint.riag.com**.

Website of Interest

The following website may be of interest to the nonprofit sector.

https://nonprofitlawblog.com

The NEO Law Group nonprofit law blog features matters of interest to nonprofit organizations to help founders understand the various considerations and issues involved with starting and operating a nonprofit. Categories accessed via the top menu bar include startups, fiscal sponsorship, boards, foundations, collaborations, and social enterprise. Additional categories, such as advocacy and lobbying; current affairs and opinion; resources; and tweets of the week, among many others, are listed in the dropdown menu above the search bar. Among the blog postings, the site also offers a step-by-step guide for starting a California nonprofit (**https://calnonprofits.org/component/content/article/10-feature-articles/201-step-by-step-guide-for-starting-a-california-nonprofit**). (The information may also be useful for nonprofit startups in other states.) Follow on Facebook (@nonprofitlaw), Twitter (@GTak), LinkedIn(Gene Takagi), and YouTube (NEO Law Group).

Auditing Brief

ADDENDUM TO THE 2020 COMPLIANCE SUPPLEMENT AND AICPA REPORTING ILLUSTRATIONS AFTER IMPLEMENTATION OF SAS 134 AND RELATED REPORTING STANDARDS EXPECTED SOON. If you have been waiting for the 2020 Compliance Supplement addendum relating to COVID-19-related federal programs and the post-SAS 134 AICPA report illustrations, you are not alone.

OMB has indicated that the addendum, which will address new COVID-19-related federal programs and information on modified compliance requirements that are relevant to COVID-19 for existing programs, should be released in mid to late December 2020. However, it was not released before this issue of *The PPC Nonprofit Update* was finalized.

The AICPA now projects that they will release updated report illustrations updated for SAS 134 and related reporting SASs in early 2021. An upcoming issue of this newsletter will discuss details about the Compliance Supplement addendum and the updated reports.

Inflation-adjusted Amounts for 2021

The following inflation-adjusted amounts apply for 2021 [Rev. Proc. 2020-45 (2020-46 IRB 1016)].

Low-cost Articles

Charitable organizations normally can distribute low-cost articles in connection with a fundraising campaign without fear that the IRS will treat the activity as an unrelated business activity [IRC Sec. 513(h)(1)(A)]. A low-cost article is an item that costs the organization no more than $11.30 in 2021 (up from $11.20 in 2020).

Insubstantial Benefits

The deductible portion of a donor's contribution normally must be reduced by the value of anything received in return. However, an insubstantial benefit can be ignored, therefore allowing a full deduction, if the gift otherwise meets the requirements for claiming a contribution. The following alternative limitations are used to determine if benefits are insubstantial:

1. The fair market value of all benefits received is not more than the lesser of $113 for 2021 (up from $112 in 2020) or 2% of the contribution.
2. The contribution is at least $56.50 for 2021 (up from $56 in 2020), and the cost of the benefits received is no more than the low-cost article value of $11.30 for 2021 (up from $11.20 for 2020).
3. In connection with a fund-raising campaign, the benefits are distributed free to potential donors who neither requested nor expressly consented to receiving them, and their cost is no more than the low-cost article value of $11.30 for 2021.

Lobbying Expenditures

If a Section 501(c)(4) social welfare organization, a Section 501(c)(5) agricultural or horticultural organization, or a Section 501(c)(6) organization has any lobbying expenditures, it normally must notify members of the portion of their dues that is nondeductible because of such expenses [IRC Sec. 6033(e)(1)(A); Rev. Proc. 98-19 (1998-1 CB 547)].

However, Section 501(c)(4) and (c)(5) entities are exempt from the notification requirements if (1) more than 90% of the annual dues comes from certain other tax-exempt entities, or (2) more than 90% of the dues comes from members who annually pay $120 or less for 2021 (up from $119 for 2020).

Agricultural or Horticultural Organization

The dues and similar income of an agricultural or horticultural organization are not subject to unrelated business income tax, regardless of the benefits or privileges to which the entity's members are entitled, if the annual dues do not exceed $173 for 2021 (up from $171 in 2020) [IRC Sec. 512(d)(1)].

Penalty Provisions

Some of the penalty provisions under IRC Sec. 6652 are adjusted for inflation. Those that apply to tax-exempt organizations or their managers are summarized as follows.

Failure to File Return under IRC Sec. 6033(a)(1). Exempt organizations can be assessed penalties for failure to file returns. The following penalties (not all inclusive) are for returns required to be filed in 2022.

Scenario	Daily Penalty	Maximum Penalty
Organization with gross receipts of $1,094,500 or less	$20	Lesser of $10,500 or 5% of the organization's gross receipts for the year
Managers	$10	$5,000
Public inspection of annual returns	$20	$10,500
Public inspection of exemption applications and notice of status	$20	No limit

For a tax-exempt entity with gross receipts over $1,094,500, the daily penalty is $105, with a maximum penalty of $54,500.

Failure to File Disclosure Required under IRC Sec. 6033(a)(2). The daily penalty is $105, with a maximum penalty of $54,500.

Failure to File Return under IRC Sec. 6043(b). Terminated exempt organizations and their managers can be penalized. This list is not all inclusive.

Scenario	Daily Penalty	Maximum Penalty
Organization	$10	$5,000
Managers	$10	$5,000

Other Penalty Provisions. There are several other penalty provisions (both taxpayer and preparer) that are adjusted annually for inflation, but they are not specific to tax-exempt organizations. See Rev. Proc. 2020-45 (2020-46 IRB 1016) for additional inflation-adjusted amounts for various penalties.

Final Regulations Clarify Separate Trade or Business

The IRS has released final regulations (TD 9933) that provide guidance on how an exempt organization (EO) subject to the unrelated business income tax (UBIT) determines if it has more than one unrelated trade or business (UTB) and, if so, how the exempt organization calculates its unrelated business taxable income. In the June 2020 edition of this newsletter, the proposed regulations were discussed. The following discussion highlights some of the changes provided in the final regulations. Stay tuned for further coverage of the final regulations in a future edition.

Multiple UTBs

The Tax Cuts and Jobs Act (TCJA) introduced separate UBIT calculations for each trade or business (the so called "Siloing" rules). Many questions emerged regarding how to implement these changes, and the IRS has responded with several iterations of guidance, including FAQs, notices, proposed regulations, and now final regulations.

Changes in classification. The proposed regulations indicated that it would not be possible to change the two-digit code (first two digits of the NAICS code) originally chosen for a separate UTB unless the change was due to an unintentional error. However, Reg. 1.512(a)-6(a)(3) provides that a change in identification of a separate UTB may be necessary to correct a partnership interest that was incorrectly designated as a qualifying partnership interest (QPI).

Codes only reported once. An organization will report each NAICS two-digit code only once. For example, a hospital organization that operates several hospital facilities, all of which include pharmacies that sell goods to the general public, would include all the pharmacies under the NAICS two-digit code for retail trade, regardless of whether the hospital organization keeps separate books and records for each pharmacy.

Investment Activities

For UBIT, an EO's investment activities are treated collectively as a separate UTB. Generally, these investment activities are limited to: (1) qualifying partnerships interests (QPI), (2) qualifying S corporation interests (QSI), and (3) debt-financed property [Reg. 1.512(a)-(6)(c)]. Exceptions apply for Section 512(a)(3) items and Section 501(c)(7) organizations. The final regulations have clarified how to qualify an investment as a QPI or QSI.

Qualifying partnership interests (QPIs). For a directly-held partnership interest to be considered a QPI, it must either meet the requirements of the *de minimis test* or the *participation test* [described in Reg. 1.512(a)-(6)(c) and (4), respectively]. While the IRS retained the *de minimis* test from the proposed regulations, in an effort to clarify intent, the control test is replaced with a participation test.

De minimis test. No more than 2% of the profits interest and no more than 2% of the capital interest of the partnership are held during the EO's tax year in which the partnership's tax year ends [Reg. 1.512(a)-6(c)(3)]. For this test, an EO's profits interest in a partnership is determined in the same manner as its distributive share of the partnership income under IRC Sec. 704(b). The EO's capital interest (for both the *de minimis* and *participation tests*), unless there is a provision in the partnership agreement, is determined on the basis of its interest in the assets of the partnership that would be distributable to the EO on its withdrawal from the partnership, or on liquidation of the partnership, whichever is greater. An EO generally determines its average percentage interest by taking the average of the percentage at the beginning of the year and the end of the partnership's tax year [Reg. 1.512(a)-6(c)(5)]. The regulations provide exceptions if the partnership interest fails to meet the *de minimis* or *participation test* because of an increase in the percentage interest in the current tax year [Reg. 1.512(a)-6(c)(6)].

Participation test. No more than 20% of the capital interest of the partnership is held either directly or indirectly during the EO's tax year in which the partnership's tax year ends, *and* the EO does not significantly participate [as described in Reg. 1.512(a)-6(c)(iii) in the partnership [Reg. 1.512(a)-6(c)(4)]. An EO significantly participates if any of the following apply:

1. The EO, by itself, may require the partnership to perform, or prevent it from performing, any act that significantly affects operations.
2. Any of the EO's officers, directors, trustees, or employees have rights to participate in the management of the partnership at any time.
3. Any of the EO's officers, directors, trustees, or employees have rights to conduct the partnership's business at any time.
4. The EO, by itself, may appoint or remove any of the partnerships' officers or employees or a majority of directors.

Note: When determining the average percentage interest for these tests, the EO may rely on the Schedule K-1 (Form 1065) received from the partnership if the percentage interests are specifically provided.

Caution: Any partnership in which an organization is a general partner under applicable state law is not a QPI. It does not matter what the EO's percentage interest is [Reg. 1.512(a)-6(c)(8)].

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If a directly-held partnership interest is not a QPI, the general principles of IRC Sec. 512(c) apply and the EO must identify the UTBs of both the directly-held partnership and any indirectly-held (lower-tier) partnership.

Indirect QPIs. The regulations deal with the complex issue of indirect ownership. Reg. 1.512(a)-6(c)(2)(ii) provides a look-through rule that is applied to an indirectly-held partnership interest that allows more interests to be included as investment activity.

An indirectly-held partnership interest may potentially qualify as a QPI (by meeting either the *de minimis* test or the participation test previously discussed) when the directly-held partnership did not qualify. When considering the *de minimis* test, the organization may (but is not required to) aggregate its interest in a lower-tier partnership with its other QPIs if the organization indirectly holds 2% or less of the capital and profits interests of a lower-tier partnership. For the *participation test*, an indirectly-held partnership meets the requirements by meeting the requirements of the test with respect to the partnership that directly owns the interest in the indirectly-held partnership. [See Reg. 1.512(a)-6(c)(2)(C) and (D).]

Qualifying S corporation interests (QSIs). Generally, if an EO owns stock in an S corporation (S) the interest is treated as a separate UTB under Reg. 1.512(a)-(6)(a). However, if the S interest meets the requirements for either the *de minimis* or *participation tests* previously described for a QPI, the S income is considered QSI and may be aggregated with UBTI from other investment activities. In applying these tests, substitute "S corporation" for "partnership," "shareholder(s)" for "partner(s)," "stock ownership" for "profits interest" and "capital interest," and "Schedule K-1 (Form 1120-S)" for "Schedule K-1 (Form 1065)."

Tax Briefs

IRS REVISING FORM 1024-A FOR ELECTRONIC FILING. The IRS is revising Form 1024-A [Application for Recognition of Exemption Under Section 501(c)(4)] and its instructions to allow electronic filing. The IRS expects electronic filing to be available early in 2021, at which point Form 1024-A must be submitted online at **www.pay.gov**. The IRS will provide a grace period during which it will continue to accept paper versions of Form 1024-A. Draft instructions for the revised form are available at **www.irs.gov/pub/irs-dft/i1024a--dft.pdf** [EO Update (11/20/20)].

IRS PREMATURELY ISSUES AUTO-REVOCATION NOTICES. A calendar-year exempt organization generally must file Form 990 by May 15 of the following year. In response to the COVID-19 pandemic, the IRS extended the 2019 Form 990 deadline from May 15, 2020, to July 15, 2020 [Notices 2020-23 (2020-18 IRB 742) and 2020-35 (2020-25 IRB 948)]. If an EO fails to file the required Form 990 for three consecutive years, its exempt status is automatically revoked. Due to systemic limitations, the IRS was unable to update the form deadline in its program that issues automatic revocation notices. As a result, some revocation notices were issued to EOs prematurely. The IRS is currently processing paper filings that allow for the reversal of auto-revocations issued prematurely and corresponding with organizations that were impacted. Affected EOs can fax documentation of their compliance with the filing requirements to the IRS dedicated fax number (855) 247-6123 [E-news for Charities & Nonprofits (10/26/20)].