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YH ADVISORS IS PROUD TO PUBLISH AND DISTRIBUTE THE YH EXEMPT ORG ADVISOR A QUARTERLY PUBLICATION FOCUSED EXCLUSIVELY ON THE TAX, LEGAL AND ACCOUNTING ISSUES OF ALL DIFFERENT TYPES OF EXEMPT ORGANIZATIONS.



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YH Advisors, located in Huntington Beach, California, is solely focused on addressing the tax, legal and accounting needs and issues of exempt organizations. The firm's Partners, Brian Yacker and Lauren Haverlock, have cumulatively consulted with exempt organizations for almost 30 years.

The YH Exempt Org Advisor is electronically available on a complimentary basis to anyone who is included in our e-mail database. If you happen to be forwarded a copy of this publication and would like to receive future copies, please contact us with your e-mail address at info@yhadvisors.com.

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Ripped from the EO Headlines

state property tax exemptions for exempt organizations

In these economically challenging times, a number of states have recently become noticeably stricter in the granting of property tax exemptions to charities located within their boundaries. For example, in California, state officials have authorized signature gathering for a constitutional amendment to revoke the property tax exemption for churches and other buildings used for worship or other religious purposes. The Legislative Analyst's Office has estimated that if the amendment is approved, local governments in California would collect an additional \$225 million in annual property tax revenue.

the absolute importance of a charitable contribution acknowledgement

In a recent Tax Court decision, *Durden v. Commissioner*, made public in May of 2012, the Tax Court ruled in favor of the Internal Revenue Service in disallowing the charitable contribution deductions of the taxpayers. In this particular case, the taxpayers contributed over \$25,000, via checks, to their church during the 2007 tax year. The taxpayers received a charitable contribution acknowledgement from the church on January 10, 2008, however, such acknowledgement did not include the required statement regarding whether any goods or services were provided to the taxpayers in consideration for their contributions.

In June of 2009, the church did forward a charitable contribution acknowledgement to the taxpayers which included all of the required language pursuant to §170(f)(8) of the Internal Revenue Code. However, this "second" charitable contribution acknowledgement was not deemed to be valid since it was not contemporaneous (to be contemporaneous, the charitable contribution acknowledgement would have needed to have been forwarded to the taxpayers before they filed their 2007 individual income tax returns).

At the end of the day, the taxpayers possessed an incomplete "first" charitable contribution acknowledgement

and a late "second" charitable contribution acknowledgement, and as such, they were not entitled to a charitable contribution deduction.

Please do not hesitate to contact Brian Yacker at 310-982-2803 or at byacker@yhadvisors.com if you have any questions regarding the foregoing or if you need any additional information whatsoever regarding the exempt organization tax, legal and accounting services which YH Advisors provides.

Focus on the IRS TE/GE Division

online ministry denied tax exempt status

Recently, in PLR 201232034, the Internal Revenue Service denied tax-exempt status to an online Christian ministry and also found that such organization did not qualify as a church. Regarding the lack of qualification as a church, the Internal Revenue Service cited the following fourteen church characteristics which were set forth in the American Guidance Foundation case (1980):

1. a distinct legal existence
2. a recognized creed and form of worship
3. a definite and distinct ecclesiastical government
4. a formal code of doctrine and discipline
5. a distinct religious history
6. a membership not associated with any other church or denomination
7. an organization of ordained ministers
8. ordained ministers selected after completing prescribed studies
9. a literature of its own
10. established places of worship
11. regular congregations
12. regular religious services
13. schools for the religious instruction of the young
14. schools for the preparation of its ministers

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In reviewing these characteristics, no single factor is controlling although some are “relatively minor” in importance while others are of “central importance.” For example, a church’s principal means of accomplishing its religious purposes must be to assemble regularly a group of individuals related by common worship and faith. The online Christian ministry addressed in this private letter ruling did not possess this important characteristic since the IRS found that having a website on the internet does not qualify as a place of worship, nor do individuals accessing that website constitute a congregation assembled to worship.

deductibility of contributions to disregarded entities

In early August of 2012, the Internal Revenue Service issued IRS Notice 2012-52 which set forth that contributions made to single-member LLCs which are wholly-owned by public charities (§501(c)(3) entities) are eligible for charitable contribution deductions to be taken by the donors under Section 170 of the Internal Revenue Code. This guidance provided by the Internal Revenue Service is only applicable for gifts made to domestic single-member LLCs. This is encouraging guidance for public charities which have decided to create single-member LLCs for whatever reasons.

IRS Notice 2012-52 sets forth that it is essential for the charity owner of the single-member LLC which is receiving the donation to be responsible for issuing the appropriate charitable contribution acknowledgement to the donor pursuant to §170(f)(8) of the Internal Revenue Code. Additionally, regarding this charitable contribution acknowledgement which needs to be prepared by the charity itself, in IRS Notice 2012-52, the Internal Revenue Service recommends that such acknowledgement contain an explicit disclosure that the single-member LLC receiving the donation is wholly-owned by the charity. Finally, this foregoing guidance is effective for all donations made to single-member LLCs after July 30, 2012.

Please do not hesitate to contact Brian Yacker at 310-982-2803 or at byacker@yhadvisors.com if you have any questions regarding recent IRS activities in the exempt organizations sector.

YH Case Study

§509(a)(2) public charities

Notwithstanding the fact that the great majority of organizations qualifying as public charities are §509(a)(1) public charities, there are still many §501(c)(3) entities which qualify as public charities under §509(a)(2) of the Internal Revenue Code. The intricacies of §509(a)(2) are sometimes overlooked since the majority of §501(c)(3) entities qualify as §509(a)(1) public charities. One of those intricacies involves the exclusion of certain governmental contributions revenue from the numerator of the public charity’s public support fraction.

In our client’s situation, they are a §509(a)(2) public charity which annually receives a significant amount of their total funding from governmental contributors. Accordingly, in order to ascertain whether our client was adequately satisfying the §509(a)(2) public support test, we needed to obtain detailed financial information regarding the exact identity of their governmental contributors.

This is because when calculating public support (the numerator of the public support fraction) under §509(a)(2) of the Internal Revenue Code, contributions received from affiliates or bureaus of governmental units are severely limited while at the same time they are included in full when calculating total support (the denominator of the public support fraction) under §509(a)(2) of the Internal Revenue Code. That being said, for our client, we analyzed each of their inflows from governmental sources and made a determination for each regarding whether the ultimate governmental payor was considered to be a governmental unit or whether the ultimate governmental payor was considered to be an affiliate or a bureau of a governmental unit.

Please do not hesitate to contact Brian Yacker at 310-982-2803 or at byacker@yhadvisors.com if you have any questions regarding public charities or if you would like more information regarding the public support test consulting which YH Advisors regularly conducts.

YH Quick Tips

form 990 reporting

There are many areas of the Form 990 that are often misunderstood. The reason for this misunderstanding isn't the complexity of the reporting rules themselves, but the difficulty of actually being able to discern what the IRS wants to see reported. The 180 pages of Instructions for the Form 990 and its schedules change frequently, and oftentimes preparers have to look beyond the Form and Instructions for clarification. The following is a list of quick tips to help with the preparation of the Form 990.

- An estimate is sufficient when reporting the number of volunteers on Part I, Line 6 of the Form 990.
- Total program service revenue reported on Part III, Line 4 should tie exactly to the total program service revenue reported on Part VIII of the Form 990.
- There are certain expenses which the Internal Revenue Service sets forth generally must be allocated completely to management and general on Part IX of the Form 990. These can be found in the Instructions of the Form 990.
- Grants received from governmental entities generally need to be reported on Schedule B.
- On Part VII of the Form 990, you should never check both the "Key employee" and "Officer" boxes in column (C).
- If the public charity has been in existence for at least five years, the charity can switch between the Schedule A, Part II and Schedule A, Part III public support tests at their whim without needing to make any sort of election.
- The filing organization will sometimes need to report an amount of Part V, Line 2a even if they do not directly compensate any employees.
- Related party transactions in excess of \$50,000 generally need to be reported on Schedule R, Part V.

The YH "Plain English" EO Dictionary

private operating foundations

There are two types of §501(c)(3) tax-exempt entities; public charities and private foundations. Within the private foundation universe, there are generally two different types of private foundations: non-operating private foundations and private operating foundations. Although the vast majority of private foundations are non-operating private foundations, private operating foundations are still somewhat prevalent in the charity world.

A private operating foundation is essentially a hybrid between a public charity and a private foundation. A private operating foundation possesses certain characteristics of a public charity, such as the same charitable contribution deduction limitations and thresholds and not being subject to minimum distribution requirements. However, private operating foundations also possess certain characteristics of private foundations in that they are subject to the §4940 tax on net investment income, they are subject to the §4941 self-dealing rules and they are subject to the §4945 rules regarding taxable expenditures.

Essentially, a private operating foundation is a foundation that undertakes charitable programs and activities on their own behalf as opposed to making grants similar to non-operating private foundations. Mechanically, in order for a private foundation to be considered a private operating foundation, the foundation must satisfy the income test and also one of three alternative tests (assets or endowment or support test).

The income test is designed to ensure that the private foundation is actually undertaking charitable activities on their own behalf as opposed to just making grants to public charities. It is important to note here that the grantmaking activities of a private foundation are not considered to be charitable activities.

Regarding the three alternative tests, the endowment test is typically the easiest to pass. Essentially, the endowment test is designed to discourage the accumulating of an excessive amount of investments or other assets which are not actively utilized in charitable undertakings.

The EO Accounting Spotlight

The California Nonprofit Integrity Act of 2004

The California Nonprofit Integrity Act of 2004 (hereinafter referred to as the “Act”), first effective for California charities beginning on January 1, 2005, was intended to do just that: instill confidence in the public that charitable organizations based in California are operating with the highest levels of integrity. One way in which the Act ensures this is by requiring a financial audit be obtained by “large” charitable organizations operating in California which fall under the parameters of the Act. However, there are numerous issues to be resolved in order for a charitable entity in California to ascertain whether they are required to have audited financial statements prepared.

In California, charitable corporations, unincorporated associations and charitable trusts are required to have audited financial statements prepared for any year in which they accrue \$2 million or more in gross receipts. Educational institutions, hospitals, cemeteries and religious organizations are exempt from this audit requirement. Gross receipts include one-time donations, non-cash contributions, realized gains or losses on the sale of investments (other than operational assets) and special events revenue (less the direct costs of conducting the special event). It is important to note here that unrealized gains and losses are NOT included in the Act’s gross receipts calculation. The Act specifically sets forth that an organization’s Form 990 or Form 990-PF will be the best source of calculating an organization’s gross receipts; specifically, gross receipts can be found on Line 12 of the Form 990 or Part I, Line 12, column (a) of the Form 990-PF. Accordingly, charitable entities in California with gross revenues of \$2 million or more must have audited financial statements prepared by an independent CPA in accordance with Generally Accepted Auditing Standards (GAAS).

Pursuant to the terms of the Act, the audited financial statements for the charitable entity are required to be made available to both the California Attorney General and the general public within nine months after the close of the fiscal year covered by the financial statements and remain available for three years in the same fashion in which the charitable organization’s Form 990 must also be made available (upon request at the organization’s prin-

cipal place of business, by mail, or on the organization’s website).

As also set forth in the Act, if a charitable entity’s gross receipts exceed the \$2 million threshold, then in addition to the audited financial statement requirements, the entity is also required to establish and maintain an Audit Committee. In California, the Audit Committee for a charitable entity must be appointed by the governing board and may include persons who are not members of the governing board. Members of the Finance Committee may be members of the Audit Committee but the Chair of the Audit Committee may not be a member of the Finance Committee. Staff members of the organization, including top management, or any person having a material financial interest in doing business with the organization, are restricted from being members of the Audit Committee. Compensation, if any, of Audit Committee members must not exceed what Board members receive for service on the Board.

The Audit Committee is responsible for engaging the independent CPA, reviewing the audited financial statements and approving non-audit services performed by the CPA to ensure proper Yellow Book regulations are followed. As a best practice, an additional function of an Audit Committee would include oversight of internal controls.

Outside of California, about half of the other states have enacted rules in their states similar to California’s Act. However, to the best of our knowledge, California’s gross receipts threshold of \$2 million is the highest. For those public charities receiving donations from donors located outside of their “home states”, these audited financial statement rules are just another requirement that charitable entities need to be aware of.

Please do not hesitate to contact Stacey Bergman at 310-982-2805 or at sbergman@yhadvisors.com if you have any questions regarding the foregoing or if you need any additional information whatsoever regarding the exempt organization accounting services that YH Advisors provides.

Welcome, Stacey Bergman!

YH Advisors is excited to welcome our newest addition, Stacey Bergman. Stacey joins YH Advisors as a Manager, with an immense amount of expertise and experience working with exempt organizations, particularly on the audit/accounting side. Stacey's primary focus will be in the conducting of the following:

- Helping exempt organizations get ready for their financial reviews and audits by aiding in the preparation of workpapers and other documentation and pulling together PBC information
- Working with exempt organizations in the preparation of their internal financials
- Preparing the federal and state information tax returns for exempt organizations
- Helping with the implementation of internal controls and accounting procedures for exempt organizations
- Providing bookkeeping services to exempt organizations, particularly smaller ones

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Upcoming Webinars

YH Advisors will continue to periodically conduct (about once every 2.5 months) 100-minute interactive technical webinars focusing on the tax, legal and accounting issues most relevant to exempt organizations. Next up will be "The Hottest "Hot Button" Issues in EO Compensation" to be presented on October 4, 2012 at 11:00 AM Pacific time. As with all the webinars conducted by YH Advisors, 2 hours of CPE credit will be available to all registered attendees. Click here for more information.

YH Presentations

Please find following a listing of the various presentations that YH Advisors made or is scheduled to make in August through October of 2012. Please do not hesitate to contact us for more information if you have interest in attending any of the upcoming presentations.

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| Aug 14, 2012 | Form 990: What You Need to Know (CalCPA) San Mateo, CA |
| Sept 25, 2012 | Form 990: Complex Issues Honolulu, HI |
| Sept 26, 2012 | Advanced EO Legal Issues Honolulu, HI |
| Oct 25, 2012 | Private Foundation Tax Primer (CalCPA) Orange County, CA |

Next Issue of the YH Exempt Org Advisor

The Fall 2012 edition of the YH Exempt Org Advisor will be published after the very busy November 15, 2012 exempt organization information and tax return filing deadline.

