

WINDES NONPROFIT ADVISOR



The Windes Nonprofit Advisor is a periodic technical publication focusing on the tax, regulatory, and accounting issues that nonprofit organizations routinely confront.

On the tax side, the Windes Nonprofit Group possesses experience in preparing and reviewing Forms 990, 990-T, 990-PF, and state tax-exempt forms, in addition to having experience in the preparation and filing of both federal and state tax exemption applications for public charities, private foundations, and other exempt organizations. Furthermore, we can assist in providing valuable guidance (governance / reasonable compensation documentation / public support test / special events / lobbying / transactions with related parties) to nonprofit organizations.

On the audit side, the Windes Nonprofit Group prepares audited financial statements and ERISA audits for over 80 nonprofit organizations. For retirement plans, Windes has experts on staff for §403(b) plan administration and compliance, including plan document issues, Form 5500 preparation and filing, non-discrimination testing and government compliance programs.

Our Nonprofit Group is composed of the following individuals who are dedicated to providing nonprofit organizations with high-level tax, regulatory and accounting consulting, tax compliance services, and financial statement audit and assurance services:

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LLCs: THE “CHARITABLE” ALTERNATIVE TO PRIVATE FOUNDATIONS

The news in philanthropy over the last few months has been about Mark Zuckerberg and his \$45 billion gift (or was it a gift?) of 99% of his Facebook stock to charity. What is all the hubbub about? What did he actually do? Why is he being both praised and criticized for taking this step? What does this mean for nonprofits going forward?

Many philanthropists, when they want to make a large contribution like this, will set up their own private foundation to receive the gift. For example, Bill and Melinda Gates donated shares of Microsoft to the Bill and Melinda Gates Foundation and it is now the largest foundation in the United States. What Mark Zuckerberg and his wife Dr. Priscilla Chan are doing is transferring Facebook shares to a Delaware limited liability company (LLC) named the Chan Zuckerberg Initiative. This is not a new technique used to engage in philanthropic activities. Previously, Laurene Powell Jobs, Steve Jobs’ widow, created the Emerson Collective, also an LLC.

HOW DOES THE CHARITABLE LLC WORK?

The Chan Zuckerberg Initiative will not be a 501(c)(3) tax-exempt entity. It will be treated as a pass-through entity for income tax purposes, thus all of the income, expenses and other tax attributes will flow through to the members (the Zuckerbergs) who will report that income on their individual income tax return. Because Facebook stock does not currently pay dividends, there may be little taxable income to pass out to the Zuckerbergs.

Because it is not a private foundation, the Zuckerbergs will not receive a charitable contribution deduction when they contribute their stock to the LLC. But this may not matter to them because without Facebook paying dividends, their income is most likely not high enough to take advantage of the charitable deduction. If they had made the contribution to a private foundation, the charitable contribution that they could take each year would be limited to 20% of their adjusted gross income. This could be carried over for five years, but they would never be able to utilize the full tax deduction of \$45 billion.

If the Chan Zuckerberg Initiative does decide to make contributions to charity, as a pass-through entity, the LLC would pass those deductions out to the Zuckerbergs. Instead of giving cash to the charities, the LLC would most likely give appreciated Facebook stock to the charity. This would produce a charitable deduction equal to the fair market value of the stock at the date of the gift, but would not trigger any capital gain recognition at the LLC level, and the Zuckerbergs would therefore avoid paying capital gains tax on the shares gifted.

Using a charitable LLC avoids many of the requirements and restrictions that are imposed on private foundations. An LLC is not required to file a Form 990-PF Return of Private Foundation, which is open for public inspection. An LLC also does not have to meet the five percent annual distribution requirement that applies to private foundations. There is no requirement to limit the amount of stock and other interests in business enterprises that can be held, called the “excess business holdings rule.” There is no requirement to follow the “jeopardy investment rule” limiting the type of investments



that can be made including speculative investments in start-up companies. The “self-dealing rules,” limiting transactions from taking place with founders would not apply, and expenditures for political and lobbying purposes can be made because the “taxable expenditures rules” would not apply as they do with private foundations.

CRITICISM OF THE LLC PLAN

Critics of the Zuckerbergs plan say they did not make a charitable contribution, which is true. However, they will be placing the stock in the LLC which was created for charitable purposes. The stated purpose of the Chan Zuckerberg Initiative is “to join people across the world to advance human potential and promote equality for all children in the next generation.” Mark Zuckerberg explains his use of the LLC in the quote below:

“The Chan Zuckerberg Initiative is structured as an LLC rather than a traditional foundation. This enables us to pursue our mission by funding nonprofit organizations, making private investments and participating in policy debates – in each case with the goal of generating a positive impact in areas of great need. Any net profits from investments will also be used to advance this mission. By using an LLC instead of a traditional foundation, we receive no tax benefit from transferring our shares to the Chan Zuckerberg Initiative, but we gain flexibility to execute our mission more effectively. In fact, if we transferred our shares to a traditional foundation, then we would have received an immediate tax benefit, but by using an LLC we do not. And just like everyone else, we will pay capital gains taxes when our shares are sold by the LLC.”

Jesse Eisinger, in his article “How Mark Zuckerberg’s Altruism Helps Himself,” is highly critical of the Zuckerberg plan and states “an LLC can invest in for-profit companies (perhaps these will be characterized as societally responsible companies, but lots of companies claim the mantle of societal responsibility). An LLC can make political donations. It can lobby for changes in the law. He (Zuckerberg) remains completely free to do as he wishes with his money. That’s what America is all about. But as a society, we don’t generally call these types of activities “charity.”

Eisinger continues: “What’s more, a charitable foundation is subject to rules and oversight. It has to allocate a certain percentage of its assets every year. The new Zuckerberg LLC won’t be subject to those rules and won’t have any transparency requirements.”

WHAT DOES THIS MEAN FOR NONPROFITS GOING FORWARD?

The use of the charitable LLC is a compelling option for philanthropists. Interest in an execution of this type of plan continues to grow. Grantwriters need to become familiar with the increasing use of charitable LLCs by philanthropists. Unlike with a private foundation, the LLC tax forms will not be available to the public. Julie Johnson in her online article “How Do Grant Writers Need to Consider Charitable LLCs?” has the following suggestions:

- If LLC has a website, visit it regularly. Watch for online application openings.
- Follow the LLC in the news media. Sign up for Google alerts with the LLC name.
- Seek the LLC on social media and follow. (Facebook is an obvious follow for CZII!)

- If LLC has a blog or newsletter, subscribe
- Identify if anyone in your NPO has a contact with anyone in the LLC

The forward-thinking nonprofit organization will take this all into consideration. Rather than criticizing the Zuckerbergs for what they have done, it would be more beneficial to determine how to make this trend work to your organization's advantage by gaining the attention of similarly-missioned charitable LLCs.

For more information or questions about how this feature affects your plan, please contact Donita Joseph at djoseph@windes.com or by phone at **844.4WINDES** (844.494.6337).



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403(b) PLANS: SPECIAL CATCH-UP RULES

Section 403(b) plans have a special catch-up feature that can allow long-term employees the ability to make additional contributions in the latter part of their careers. The calculation of the special catch-up is complicated and must take into account prior contributions over an extended period of time.

The expanded contribution limits are available to employees with more than 15 years of service with a “qualified organization.” This is defined as:

- An educational organization
- A hospital
- A home health service agency
- A health and welfare agency
- A church or convention of churches

A participant who qualifies for the special catch-up under Code section 402(g)(7) is allowed an additional deferral of up to \$3,000 per year. This increase is on top of the regular catch-up limit for individuals over age 50. This means that an individual who qualifies for both catch-ups would have a 2016 elective deferral limit of **\$27,000** (the 401(k) limit of \$18,000, plus the regular catch-up limit of \$6,000, **plus** the special catch-up limit of \$3,000).

Service is only counted with one qualified organization and its predecessor. The amount of the special catch-up is limited to a lifetime \$15,000 and is reduced by a formula that takes into account years of service and prior elective deferrals.

The special catch-up limit is unique to 403(b) plans and can be a boon to a qualified individual who desires to maximize his or her retirement benefits. The calculation of the limit does require that records on qualified individuals be maintained beyond the normal 10-year retention period.

For more information or questions about how this feature affects your plan, please contact Richard Green at rgreen@windes.com or by phone at **844.4WINDES** (844.494.6337).



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REVISED PROCUREMENT STANDARDS UNDER THE UNIFORM GUIDANCE

On December 26, 2013, the Federal Office of Management and Budget (OMB) issued the Super Circular in the form of final regulations titled Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (the Uniform Guidance, or UG), which superseded many of the circulars with which most nonprofits are familiar, such as OMB A-133. The Uniform Guidance became effective for all new federal awards and incremental funding on existing awards after December 26, 2014. For most nonprofit organizations, the fiscal year ending June 30, 2016 would be the first full fiscal year the Uniform Guidance would be effective.



One section of the Uniform Guidance that nonprofits may find more restrictive than prior OMB circulars is the Procurement Standards. The new guidance on procurement has much more defined requirements than in prior guidance, and, because of this, there is a grace period to implement the new Uniform Guidance. Nonprofits have the option of deferring the implementation and following the old OMB circulars for one year, but must document the election.

In summary, the Procurement Standards requires nonprofits to:

- Document procurement procedures, which should include steps to address the different Methods of Procurement as detailed in the Uniform Guidance.
- Maintain a written policy regarding conflict of interest that addresses how employees with conflicts should be excluded from the procurement process.
- Maintain records sufficient to detail the history of procurement, including the rationale for the method of procurement, selection of contract type, contractor selection or rejection, and the basis for the contract price.
- Procurement transactions must be conducted in a manner that provides for full and open competition, unless it qualifies for a non-competitive proposal process.
- Perform cost or price analysis for all transactions that exceed the Simplified Acquisition Threshold (\$150,000). Details of the analysis may vary depending on the transaction, but a minimum estimated cost should be documented prior to receiving bids or proposals.

The Procurement Standards requires nonprofits to use one of the following Methods of Procurement:

- Micro purchases – Purchases of supplies and services where the aggregate dollar amount does not exceed \$3,000. No competitive quotes are required if management determines the price to be fair and the purchases are distributed among qualified suppliers.
- Small purchases – Purchase of supplies and services that do not cost more than the Simplified Acquisition Threshold (\$150,000). Informal purchasing procedures are acceptable, but price or rate quotes must be obtained from an adequate number of sources.

- Sealed bids – Purchase of supplies and services in excess of the Simplified Acquisition Threshold. Under this purchase method, formal solicitation is required, and the fixed price is awarded to the responsible bidder who conformed to all material terms and is the lowest in price. This method is the most common procurement method for construction contracts.
- Competitive proposals - Purchase of supplies and services in excess of the Simplified Acquisition Threshold where sealed bids are not appropriate. This procurement method requires formal solicitation where a fixed-price or cost-reimbursement contract is awarded. This also requires documentation on how the proposals were evaluated and ultimately selected.
- Noncompetitive proposal - Also known as sole-source procurement, this may be appropriate if certain conditions are met. Examples of some conditions include when an item is available only from one source, when a public emergency does not allow for the time of the competitive proposal process, when the federal awarding agency authorizes, or the competition is deemed inadequate after a number of attempts at a competitive process.

The first step for nonprofits trying to implement the new Procurement Standards should be to review their own written policies. If the policies haven't been reviewed in a long period of time, there is a good chance they are not in compliance with the new standards. Here are some key factors to consider during the review and, if necessary, revise:

- Ensure the policy, at a minimum, includes the Methods of Procurement prescribed in the new standards. This will most likely be the most significant change to the procurement process, as organizations will need to establish controls and develop methods to document their process for each method.
- Ensure the policy addresses conflict of interest to specify what constitutes a conflict of interest and how employees with conflicts are precluded from the procurement process.
- For small purchases, the standards call for obtaining an adequate number of quotes, but organizations should address what they consider an adequate number of quotes.
- Consider developing a management committee dedicated to the evaluation and selection process of sealed bids and competitive proposals. Standardized templates could be utilized to allow for consistent evaluation among the committee members.
- Summaries of the evaluations and rationale for the final selections on sealed bids and competitive bids should be prepared and presented to the board of directors for final approval.
- Develop standardized templates to help with cost/price analysis to ensure each procurement is consistently evaluated.
- Establish a document retention policy to ensure each step of the procurement process is documented and retained for the auditors during their compliance testing.

- Hold training sessions with employees responsible for procurement to ensure they understand the new standards.
- Develop a checklist to help management ensure each step of the procurement process has been completed before making a selection.

The guidance in the new Procurement Standards are the minimums that an organization needs to have in order to be in compliance. However, an organization can include additional restrictive steps as it deems necessary.

For questions or more information, please contact Tom Huey at thuey@windes.com, Kelly Buck at kbuck@windes.com, or call toll free at **844.4WINDES** (844.494.6337).

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