Mueller Prost PC
CPAs + Business Advisors

NONPROFIT INSIGHTS

Winter 2012

The Low-Down on Public Inspection Rules

Transparency is the name of the game in today's nonprofit world. The trick is to know what records must be made available - and when.

Public Inspection Requirements

In general, a tax-exempt organization must make its annual IRS returns (Form 990, 990-EZ, 990T or 990-PF) and its application for exemption (Form 1023 or 1024) available for public inspection at its principal place of business.

Form 990 – You must make all parts of your organization's three most recent Form 990s available - except for Schedule B (Schedule of Contributors), which is provided to the board and is not required to be made available for public inspection. In fact, with the exception of private foundations, organizations are not required to provide the names and addresses of contributors. Otherwise, be sure to include the appropriate schedules, attachments and supporting documents filed with these forms.

Form 1023 or 1024 – This rule applies unless the exemption application was submitted *prior* to July 15, 1987, and your organization did not have a copy of its original application on this date. Also, an organization that has not yet been recognized as tax-exempt is not required to provide a copy of its pending Form 1023. Note that you can request a copy of your organization's original application from the IRS using Form 4506-A.

In addition to these general standards, consider the following more specific rules:

Availability – Applicable forms must be made available during regular business hours. You may have a staff member present in the room during the public inspection. However, you must allow the visitor to take notes freely during the inspection.

Requests for copies – Copies must generally be provided on the same day of a request made in person, and within 30 days of receiving a request made by mail (or 30 days after receipt of payment, if advance payment is required for copies). Note that "by mail" includes requests made by fax and e-mail. If the visitor brings his or her own copying equipment (even a cell phone or compact camera) to the place of inspection, you must allow the visitor to make copies on-site free of charge.

Reasonable fees – You may charge "reasonable fees" for copying plus actual postage costs. Currently, the IRS defines reasonable fees as $1 for the first page and $0.15 for each additional page. You may also require that the fees be prepaid before copies are provided.

"Widely Available" Exception

In this age of the Internet, it is important to note that a nonprofit is not required to provide hard copies of its Form 990 or Form 1023 if it has made those documents "widely available," such as by posting the document(s) on the Internet (either on the organization's own website or as part of an online database such as GuideStar).

Further, the website must clearly inform readers that the document is available and provide instructions for downloading it. Here, posting documents in a format such as an Adobe Acrobat PDF, which does not require special hardware or software, meets the "widely available" requirement. In addition, no fee can be charged for downloading the information.

Five Steps to Take

Along these lines, GuideStar (http://www.guidestar.org) suggests five simple steps for increasing transparency utilizing your organization's website:

1. Post your annual report.

The Low-Down on Public Inspection Rules, cont'd.

2. Post your IRS letter of determination.

3. Post any audited financial statements.

4. Regularly update your site with current, detailed program and evaluation information, including evidence-based evaluation metrics.

5. Post board and key staff members' names, titles and bios highlighting each person's skills and contributions.

The Upside of Transparency

Ultimately, transparency can be a real tool for nonprofits, providing an opportunity to share with an increasingly curious public exactly how your organization operates — from finances to policies, practices and governance.

Questions about this important topic? Contact our office today for help in understanding and complying with IRS public inspection rules.

Exceptions for Harassment Campaigns

The IRS provides an important exception for organizations that feel they are the subject of a harassment campaign. In the words of the IRS, this occurs when the requests for documents "are part of a single coordinated effort to disrupt the operations of a tax-exempt organization rather than to collect information about the organization."

An organization that believes it is being targeted by such a campaign may suspend compliance with document requests while it applies for a determination by the IRS. Note that under normal circumstances, requests from members of the news media are not considered harassment, nor is an increase in requests resulting solely from an article or story appearing in the news media.

A special exception allows organizations to ignore multiple requests from a single individual or address without seeking a determination of harassment from the IRS. An organization may disregard requests beyond the first two that come from the same person or same address within any 30-day period, or beyond the first four requests within any one-year period.

Meeting the Challenges of Transparency

Ultimately, there are circumstances that require transparency - and others that require confidentiality.

If your board hasn't already, have them write an organizational confidentiality policy. Then hold people accountable to that policy, and make sure that contemplated disclosures are consistent with your policy.

- Educate your board on what matters are considered "confidential" and how these matters should be handled (typically in an executive session).

- Be aware of confidentiality "gotchas," such as fine print in contracts or grant awards, which may contain clauses requiring confidentiality.

- Determine if the type of client you serve dictates additional confidentiality - e.g., you run programs working with drug and abuse treatment, children, victims of violence or healthcare patients.

- Know what's open and what isn't. If you receive public funds, staff personnel records may be required to be open for inspection. This includes performance reviews and salaries of certain staff members. However, it's critical to know that certain personnel records may not be released (such as health records), so make sure you understand any disclosure rules regarding information about employees.

- Consult with an experienced attorney when legal matters are involved to determine what should be kept confidential (e.g., certain information regarding pending litigation).

Beware the Independent Contractor Trap

Nonprofit organizations, just like for-profit businesses, tend to use independent contractors for a very simple reason: It saves on employment taxes.

But costly problems can occur when you misclassify workers as "independent contractors" when they are actually employees in the eyes of the law. Simply put, the person your nonprofit is paying is not an independent contractor simply because you say so.

Proper worker classification depends upon a set of well-defined rules. This includes both a 20-factor test used by the IRS and a more general seven-factor test used by the U.S. Department of Labor. The penalties for worker misclassification can be crippling, including the imposition of substantial fines, penalties and back-taxes.

Employee or Independent Contractor?

As a general rule, courts look at the following four factors when deciding whether a true independent contractor relationship exists:

1. Who supplies the tools and materials? An independent contractor will supply his or her own tools and materials.

2. Is work done for other contractors? Independent contractors work for more than just one client.

3. Is there an opportunity for profit or loss? A true independent contractor faces the possibility that the job will be performed at a loss, as compared to an employee who is simply paid wages.

4. Who determines how the work is done? A true independent contractor will be able to determine the order, sequence and time he or she decides to work. An employee, by comparison, is bound by the employer's demands (i.e., work days and schedule).

Two Examples

Example #1 – Suppose you operate a homeless feeding program and your kitchen drain backs up. You call a plumber, an experienced professional who knows his business. While you may have some input or preferences about how he performs the repair, it is highly unlikely that you will stand over the plumber and instruct him on how to fix your drain. For the most part, the plumber is in control of what he does and how he does it.
Verdict: *Independent Contractor*

Example #2 – Now suppose you hire a designer to revamp your website. You provide the desk, computer, printer and all other materials and information she needs to do the job. You also set the work schedule (afternoons from 1 to 5, five days a week) and you require that your designer do the work using a specific programming language or coding standard. Finally, you require the designer to send regular progress reports and attend project meetings.
Verdict: *Employee*

Guidelines to Consider

To avoid worker misclassification issues, keep these guidelines in mind:

Watch rehires. Be careful about bringing former employees back as consultants or independent contractors. Such individuals are best treated as employees unless the situation clearly and defensibly warrants treating them as an independent contractor.

Get it in writing. Have independent contractors agree in writing that they are *not* employees and that they expressly waive any right to benefits.

Get an invoice. Ask for a formal invoice with the contractor's business name, address and other details.

Know the law. Obtain IRS Form SS-8, *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding*. Responding to the questions will help you make a clear determination.

Fill out the forms. Ensure that all Forms 1099 are properly filed for workers who are paid $600 or more during the year.

A Final Thought

While many nonprofit organizations are exempt from federal income tax, they must still withhold federal income tax from the pay of their employees, subject to special rules for Social Security, Medicare and federal unemployment (FUTA) taxes. For further guidance, be sure to consult IRS Publication 15-A, *Employer's Supplemental Tax Guide*.

Proper classification of workers is critical. Our professionals are experienced in helping nonprofit organizations such as yours remain in compliance.

Red Flag Rules: Lessons to Be Learned

After several years of debate, Congress has finally determined which businesses and organizations will fall under the identity theft prevention law commonly known as the Red Flag Rules. While certain entities are required to develop a written program to spot the warning signs - or "red flags" - of identity theft, nonprofit organizations will *not* be required to do so.

Still, the lessons to be learned concerning identity theft are real. Whether it's theft of your organization's credit profile in order to fraudulently obtain credit or a breach of confidential donor information, identity theft is a real-world concern with dire consequences. Consider these steps for protecting your organization and your donors:

Hire smart. Identity theft is often an "inside job." To head off trouble, run criminal background checks on all potential new employees.

Train your staff. Provide training for your board and staff on records management and security.

Limit access. Limit access to sensitive information (such as EINs, bank accounts and credit cards) and always encrypt sensitive data on your computer network.

Review credit reports and statements. Regularly review your organization's credit reports and carefully scrutinize employee charge card billing statements before they are paid, particularly those accounts for which multiple cards are issued.

Guard check stock. Avoid using preprinted check stock. If you must use preprinted stock, guard it like cash.

Compare notes. Talk to peers in your industry. Chances are, many of your risks are similar and you can learn from each other.

A strong system of checks and balances can help prevent identity theft. Ask us about establishing proper internal controls for your organization.