Profiting from Nonprofits

By Reg P. Wydeven
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My babies are growing up. Now matter how much I prepared myself, I still wasn't ready to bring my daughter to her first day of 4-K this year. My cover story at work was telling everyone that I woke up early to watch 'Old Yeller.'

This year we got to experience such memories as our first parent teacher conference, Christmas concert, and science fair. We also experienced something that goes hand-in-hand with school: fundraising.

We've had bake sales, sold pizzas, gift wrap and candles. Pretty soon soccer will start, so I'm sure we'll be selling candy bars. After that, Girl Scout cookies. Fundraising is a way of life for kids in extra-curricular activities.

I've had the privilege of helping organize many booster organizations in the area that support kids' sports, clubs and other activities. Part of the process of organizing nonprofits is applying for tax-exempt status with the IRS. Lately, the IRS has been taking a closer look at nonprofits.

Specifically, the IRS has been monitoring individuals associated with tax-exempt organizations who receive compensation or benefits that exceed the value of their services, goods or donations they provide to the organization.

In the past, if the IRS determined that a den mother was making too much dough, it would either ignore the infraction or take the more drastic action of revoking the organization's tax-exempt status. Because revoking tax-exempt status penalizes not only the perpetrators but also the innocent parties within the organization and the people it serves, this was typically a last resort.

To ensure the punishment fits the crime, the IRS introduced "excise taxes on excess benefit transactions." Otherwise known as intermediate sanctions, this penalty fines "disqualified persons," or those individuals who are "in a position to exercise substantial influence over the affairs of" a 501(c)(3) or 501(c)(4) nonprofit organization. These individuals include the organization's president, chief executive officer, chief operating officer, treasurer, and chief financial officer.

Other folks who may be sanctioned include voting members of a nonprofit's governing body, such as its board of directors, persons with more than 35% of the organization's voting power, substantial contributors and family members of a disqualified person. Finally, managers who "knowingly, willfully, and without reasonable cause" participate in an excess benefit transaction can also be fined.

If a disqualified person is found to have received an excess benefit, the excise tax is 25% of the amount over the true value of the services or item, however, an additional 200% can be charged if the excess benefit is not corrected by a certain date. Participating managers are liable for 10% of the excess, not to exceed $10,000 per transaction.

If a disqualified person disagrees with the IRS, three criteria can be used to establish that a transaction was not an excess benefit transaction. First, the benefit was approved in advance by the organization's governing body, which consists of individuals who do not have a conflict of interest. Second, the governing body gathered and relied on data, such as comparable studies, before making its decision. Finally, the governing body adequately documented the basis for its determination at the time it made its decision.

So if your charity pays its participants, make sure you don't pay them too much, as the IRS may come looking for a donation.

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