

Insights

Best Practices of Highly Effective Nonprofit Organizations

TAX

Private Foundations: Complying with Qualifying Distribution Rules

By Amy Dalen, JD

PRINCIPAL | CO-NATIONAL DIRECTOR,
HBK NONPROFIT SOLUTIONS



A private foundation is an organization that is exempt under IRC § 501(c)(3), but does not meet the requirements to be considered a public charity. This is generally because the private foundation is either not operating an activity that would qualify as a private charity, or the source of funds is limited to a family group, and therefore the organization is unable to show sufficient support from the general public. When an organization is classified as a private foundation, it must comply with several complicated rules governing its assets and activities. This article addresses one of the most important of those rules: the requirement to make annual qualifying distributions to avoid significant excise taxes.

Here we address one of the most important of the complex rules governing a private foundation's assets and activities: the requirement to make annual qualifying distributions to avoid significant excise taxes.

Overview

In general, a private foundation is required to distribute annually an amount equal to the foundation's "minimum investment return" in order to avoid the excise tax for a failure to distribute income. The minimum investment return generally calculates to 5 percent of the net fair market value of the foundation's assets, with some exceptions.

Only distributions that meet the definition of a "qualifying distribution" will count toward the requirement. However, if a foundation qualifies as a "private operating foundation," it is not subject to this distribution requirement.

Minimum Investment Return

A private foundation's minimum investment return is generally defined under IRC § 4942(e)(1) as 5 percent of the net value of the foundation's income-producing assets. Assets used directly by the foundation in carrying out its exempt purpose are not included in the net value. Whether or not an asset is used to carry out the foundation's exempt purpose depends on the facts and circumstances, and generally requires that the foundation have a charitable activity.

For example, a private foundation that purchases a building to carry out its future plans of operating a museum should be able to exclude the value of the building from the foundation's minimum investment return calculation. However, if the private foundation does not have plans in place to create a museum, or purchased the building solely

CONTENTS

GOVERNANCE

4 / **Leadership Changes:** Crisis or Opportunity?

6 / **HBK Nonprofit Solutions Contacts**

ASSURANCE

7 / **New Standard Changes Accounting for Leases**

OUTSIDE THE LINES

10 / **Should Your Organization Accept In-Kind Cryptocurrency Donations?**

CLIENT SPOTLIGHT

12 / **Sojourner House:** Helping Addicted Mothers Break the Cycles of Poverty and Chemical Abuse

ABOUT HBK NONPROFIT SOLUTIONS

HBK Nonprofit Solutions is a dedicated team of subject matter experts within HBK CPAs & Consultants, an Accounting Today Top 100 CPA firm. With more than 800 clients in the nonprofit sector, and more than 35 years providing financial compliance and consulting to nonprofits, we offer the hands-on experience and technical skills to help nonprofit organizations fulfill their missions.



Minimum Investment Return

A private foundation's minimum investment return is generally defined under IRC § 4942(e)(1) as 5 percent of the net value of the foundation's income-producing assets.

Qualifying Distributions

Generally speaking, qualifying distributions are administrative expenses, payments to other exempt organizations, or amounts set aside for a specific project that has a charitable purpose.

for the purpose of generating rental income, the value of the building should not be excluded.

There may be instances where assets are used for both direct charitable and non-charitable purposes. In those instances only a portion of the asset value will be included in the minimum investment return calculation. When at least 95 percent are used in direct charitable activities, assets can generally be fully excluded from the calculation.

The timing of the value is also important when calculating the minimum investment return. Cash accounts will generally be valued as a monthly average balance, whereas other assets may be valued on any day of the year, assuming the same day is used consistently each year. Real property may qualify for a special rule that allows the private foundation to obtain an appraisal every five years.

Private foundations should look at valuations carefully to ensure they are accurate. While an excise tax may apply if the valuations used are later determined to be too low, IRC § 4942(a) (2) prevents the imposition of this excise tax, provided the foundation did not act willfully and made a good faith effort to ascertain accurate values.

What Are Qualifying Distributions?

Qualifying distributions are generally administrative expenses, payments to other

exempt organizations, or amounts set aside for a specific project that has a charitable purpose:

- Administrative expenses tend to be expenses that are reasonable and necessary to accomplish the exempt purpose of the foundation. Legal and accounting fees generally qualify, as do state registration fees, trustee fees, and banking fees. To the extent any of the administrative expenses of the foundation are incurred partly for the foundation's charitable purposes and partly for other purposes, the foundation will need to allocate the expenses between purposes. Allocation is done on Page 1 of Form 990-PF.

There is no defined method for allocation, though allocations should be reasonable and consistently applied each year. We recommend looking at each administrative expense separately to determine the most accurate method of allocation. For instance, trustee fees may be allocated based on hours spent reading grant applications versus monitoring investments. In contrast, legal fee allocations may be based on the specific matter they pertain to—for example, drafting internal governance documents or giving an opinion on whether an investment strategy is aligned with the foundation's charitable purpose.

- Payments to other exempt organizations may be qualifying distributions as long as the designated organization is not controlled directly or indirectly by the foundation or its disqualified persons, with some exceptions. In addition, payments to other private foundations will generally not qualify unless the foundation receiving the payment is a private operating foundation. Interestingly, payments made to foreign organizations may be considered qualifying distributions if the foundation has made a good faith determination that the foreign organization is not considered a private foundation.
- Amounts set aside for a specific charitable project can be a qualifying distribution when the amount set aside will be used on the project within five years. In addition, the foundation must either show that the

project is better accomplished by setting aside funds instead of making immediate payments during the term of the project, or meet a mechanically defined cash distribution test that generally principally applies to foundations applying the set-aside rule shortly after organizing as a private foundation.

Ordering of Qualifying Distributions

Qualifying distributions made during a current year will first reduce any undistributed income—that is, of the minimum investment return—from the immediately preceding year if the private foundation was subject to the income distribution requirements for that year. To the extent that there are excess qualifying distributions for the current year, the private foundation can elect to apply the excess to undistributed income from years prior to the immediately preceding year. If the election is not made, or there is no undistributed income for prior years, the current year qualifying distributions will reduce distributable income for the current year. Any excess qualifying distributions are deemed “distributions of corpus,” which may reduce distributable income in future years.

IRC § 4942 Excise Taxes

If a private foundation does not make sufficient qualifying distributions to distribute the entire minimum investment return for the year, the undistributed amount carries forward to the following year. The private foundation must then make sufficient qualifying distributions to cover the undistributed amount from the prior year, or a 30 percent excise tax will be imposed on the amount that remains undistributed as of the first day of the third taxable year after the amount was required to be distributed. The excise tax will continue to apply each year until qualifying distributions are sufficient to offset the undistributed amount subject to the excise tax. (See sidebar for example.)

Conclusion

Private foundations need to be aware of their distribution requirements and the excise tax that could be assessed if the qualifying distributions they make are insufficient to meet those requirements. HBK Nonprofit Solutions is well versed in those requirements and regularly consults with nonprofits on adhering to qualifying distribution rules. To discuss the rules, or for a better understanding of how they could impact your private foundation, we encourage you to reach out to HBK Nonprofit Solutions. ■

IRC § 4942 Excise Taxes: an Example

The Smith Family Foundation calculates a minimum investment return of \$10,000 during tax year 2019, but does not make any qualifying distributions. The minimum investment return for tax year 2020 calculates to \$12,000, and the foundation makes qualifying distributions of \$5,000 by the end of tax year 2020. The qualifying distributions of \$5,000 first offset the distributable amount from tax year 2019, leaving a balance of \$5,000, against which the 30 percent excise tax is assessed in tax year 2021. The foundation will need to make qualifying distributions of at least \$17,000 during tax year 2021, and apply excess qualifying distributions to undistributed income from 2019 in order to avoid the excise tax in tax year 2022.



HBK NONPROFIT SOLUTIONS // AUTHOR PROFILE



Amy Dalen, JD

Principal | Chair, Tax Advisory Group
Co-National Director, Nonprofit Solutions

Amy is a principal and the chair of the HBK Tax Advisory Group, highly specialized professionals who provide tax training to HBK team members, oversee compliance with tax policies in order to mitigate risk to the firm, and provide client tax planning and consulting.

Amy specializes in estate, gift, trust, individual, and nonprofit taxation. She has worked with nonprofit clients since beginning her public accounting career in 2008, including reviewing more than 1,500 nonprofit tax returns for compliance since 2016. As a nonprofit specialist, she advises HBK estate planning clients on philanthropic giving. Her involvement with nonprofits dates back to her childhood: Volunteer, Muscote Farm; Member, Girl Scouts and 4-H; Volunteer, Animal Refuge League of Greater Portland, Maine.

For more information, contact Amy at 239-263-2111 or adalen@hbkcpa.com.

GOVERNANCE

Leadership Changes: Crisis or Opportunity?

By Kathleen Clayton, CPA

PRINCIPAL | CO-NATIONAL DIRECTOR,
HBK NONPROFIT SOLUTIONS GROUP



photo by Brooke Laik for Unsplash

Everyone is talking about the “great resignation,” many calling it the “great quit.” Unfortunately, exempt organizations haven’t been exempted from the trend.

The Canby (Oregon) Area Chamber of Commerce’s widely respected Executive Director Kyle Lang announced his resignation in January 2022, saying, “The last two years have taught me a lot about resilience, about the power of staying limber and loose and able to adapt in crises.” Nonprofit Quarterly has reported the average term for small and mid-sized nonprofit organization executive directors is six years. Many say the pandemic will only hasten leadership departures and retirements.

A leadership transition may come as a surprise or as part of a long-term plan. In any case, the job of the board is to move swiftly to make the transition in a smooth and controlled manner. Ideally, the departure of a leader, whether a CEO, executive director, COO, CFO, or other management team leader, should be managed by an existing succession plan. In writing for the Nonprofit Risk Management Center, contributors Melanie Lockwood Herman and

Erin Gloeckner identify succession planning as “a critical risk management issue for every board ... a planning process that will ensure the health of your nonprofit during and after a leadership change.”

Large and small nonprofits often have some form of a strategic plan, and a best practice is to include succession planning for the CEO and other organization leaders in that plan. Yet fewer than half of nonprofits actually have documented succession plans. Why? Perhaps

The average term for small and mid-sized nonprofit organization executive directors is six years. Many say the pandemic will only hasten leadership departures and retirements.

because the board fears saying to its valuable CEO or executive director, “We’re going to talk about a succession plan for you.” Best-practice strategic planning lessens this anxiety by focusing succession planning not only on one position like the CEO or executive director but on all the management team and the board.

Experts advise that any succession plan is better than none, but multiple plans should be developed based on the circumstances

surrounding the leader’s departure. The transition process differs depending on the reason behind the departure, whether it is prompted by an emergency, termination, extended medical leave, resignation, planned retirement, or another reason. The organization should develop transition plans for all leadership positions and all reasons for departures.

The Planned Departure

The planned departure allows for a thoughtful process of saying good-bye to one leader and welcoming a new leader. The entire process should be grounded in keeping the mission at the forefront of all decisions. The governance documents should be reviewed for board policies regarding the approved transition process, assuming there is one. Given that the hiring of a CEO or executive director often takes six months or longer, a timeline for the transition should be outlined and documented, and a transition team formed to manage the process.

It is vital to understand the roles and responsibilities of the outgoing leader. A detailed position description may already be part of the leader’s annual review. Is it complete? Has it changed recently? Is

the position description both people- and task-specific? It is also critical to consider a new executive in light of the goals of the organization. Is the organization looking to expand, change direction, adjust priorities, increase fundraising efforts, or change its communication strategies? Does your next leader have the skills to accomplish those goals?

Often missed in leadership changes is the passing on of institutional knowledge, including the contact list of the outgoing leader. Who gets the proverbial Rolodex? If a new leader has been identified and introductions can be made, both the new leader and the contact are likely to feel more comfortable with the transition.

It is important to communicate wisely. Identifying who needs to know, what they should hear, and who should make the announcement of a departure is vital. First, identify spokespeople regarding this news. The circumstances of the departure will control the messaging and its timing. It is important to communicate the planned transition with key stakeholders, including board members, staff members, donors, partners, the community, and the media. The transition team must realize the word will get out, so the organization needs to be upfront with its message, focusing on the organization's stability, continuity, and sustainability during the transition.

Consider how these messages resonate:

"The Board of Directors announces and congratulates our outgoing CEO on their outstanding leadership. We are excited to begin our search for a new leader." That is, we've got this covered, and we're ready.

Or as Kyle Lang said it so eloquently, "I will be sad to no longer fill my role, as I did, but I'm not going far. You will still see me around town on occasion doing community work, so stay tuned." That is, I'm not abandoning you.

The Unexpected Departure

The unplanned departure can be the result of an emergency, extended medical leave, death, or termination. In these instances, it is the job of the board to move swiftly to make the transition as smooth and controlled as possible.

One of the most important objectives in an unexpected departure is to keep the remaining team intact and to keep morale as high as possible. So tell the staff immediately and be professional with the message. And remember, some confidentiality regarding the circumstances of the departure might be needed, especially in the case of a termination.

A senior leader's departure can create uncertainty for the staff, but any accompanying chaos can often be lessened by senior team

One of the most important objectives in an unexpected departure is to keep the remaining team intact and to keep morale as high as possible. So tell the staff immediately and be professional with the message.

members. The board should immediately meet with the current staff and identify team members who might be ready and willing to step up, whether in an "acting" role or in a permanent position. The board will need to identify who will fill in and in what capacity. Can the role be shared by more than one existing team member? Depending on which leadership role is being vacated, a variety of experience, skills, and personalities might be needed. Consider the different talents required of a CEO, CFO, or Development Director. Specific responsibilities should be assigned to qualified individuals during the transition. You might hire an outside professional, if temporarily. No one should doubt that

HBK NONPROFIT SOLUTIONS // AUTHOR PROFILE



Kathleen Clayton, CPA, PSA, MBA

Principal | Co-National Director, Nonprofit Solutions

Kathleen has over 35 years of experience providing auditing, accounting, tax and consulting services to privately held businesses and not-for-profit organizations. She specializes in preparing tax-exempt status applications, consulting on charitable regulations, and providing outsourced management and accounting services. She routinely consults with organizations that receive federal and state funding.

Kathleen has worked with a wide variety of nonprofit organizations, including membership organizations, public charities, private foundations, and special improvement districts. She frequently addresses conferences and meetings, and business and governmental organizations on nonprofit-related issues. Her community service includes positions on several boards, including currently as vice-chair of the Union County Education Services Foundation and previously the Two Hundred Club of Union County and the United Way of Union County.

For more information, contact Kathleen at 732-453-6528 or kclayton@hbkcpa.com.

the operations of the organization are continuing, the programs are ongoing, and the organization is proceeding confidently into the future.

The board should explain the process of identifying the next leader to the team. Will there be a search? Who will be conducting it—the board, a search firm, a consultant? Will internal candidates be considered? Many organizations use a process called “collaborative hiring,” which allows relevant departmental or functional teams to be part of the selection process. Also called “team-based hiring,” the process allows the organization to hear the perspectives of diverse team members and promotes “ownership” among the team. As the process continues, it will be important to stay in touch with all the stakeholders, to be as open and transparent as possible.

Culture Matters

Whether the departure is planned or not, it is extremely important that the transition team consider the culture of the organization and realize much of the current culture may be tied directly to the resigning team member. Where employees are empowered to work and make decisions either on their own or in teams, a domineering leader might negatively and severely impact that culture. On the other hand, if the team is used to the leader making all the decisions, the staff might not be able to make decisions independently. Chaos can ensue and result in significant turnover—culture matters. Unfortunately, most organizations don’t define their culture in their documents, policies, or manuals.

The story of an outgoing leader

A long-time HBK client, a statewide organization, recently lost their CEO to their national organization. The transition needed to be quick, and their active board was ready and moved quickly. The outgoing CEO was confident she had developed a senior leadership team that would effectively manage the organization and was able to step away to her new role. The messages were clear: From the CEO to the board, “They can do this”; and from the management team, “We can do this.” Lucky organization. While the new leader is still being identified, the board, donors, and community can rest assured that the organization is in good hands.

Not all nonprofits are so lucky, but there are some lessons in the story. Develop bench strength. Be ready with a transition process—communication and culture matter. Act swiftly. Look to the future. And always support the mission. ■



Whether the departure is planned or not, it is important that the transition team consider the culture of the organization and realize much of the current culture may be tied directly to the resigning team member.

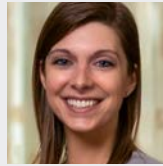
HBK Nonprofit Solutions Contacts



Kathleen Clayton, CPA, PSA, MBA
Co-National Director, Nonprofit Solutions
Principal | Clark, N.J.
T (732) 453-6528
E KClayton@hbkcpa.com



Melissa Crowley, CPA
Principal | Youngstown, Ohio
T (330) 758-8613
E MCrowley@hbkcpa.com



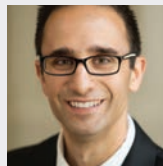
Amy Dalen, JD
Co-National Director, Nonprofit Solutions
Principal | Naples, Fla.
T (239) 263-2111
E ADalen@hbkcpa.com



Jeremy Hartzell, JD, MBA
Principal-In-Charge | Pittsburgh, Pa.
T (724) 934-5300
E JHartzell@hbkcpa.com



Sean Kocan, CPA, CFE
Principal | Pittsburgh, Pa.
T (724) 934-5300
E SKocan@hbkcpa.com



Dominic Mastropietro, III, CPA, MBA
Principal | Hermitage, Pa.
T (724) 981-7550
E DMastropietro@hbkcpa.com



Ashlynn Reeder, CPA, MST
Assistant Director, Nonprofit Solutions
Senior Manager | Naples, Fla.
T (239) 263-2111
E AReeder@hbkcpa.com



Darby Beaverson, CPA
Principal | Naples, Fla.
T (239) 263-2111
E DBeaverson@hbkcpa.com

ASSURANCE

New Standard Changes Accounting for Leases

By Darby L. Beaverson, CPA
HBK PRINCIPAL



After a series of deferrals, the new lease standard, Topic 842, is here. Your organization may be unsure how this will affect your day-to-day activities, but I can assure you, it is not something to put off or deal with at the end of the year as part of your closing process. Read on for a better understanding of what Topic 842 means for your organization, and how you should be monitoring it throughout the year.

History

FASB accounting standards codification (ASC) 842 was created by ASU No. 16 and issued in February 2016. The standard supersedes FASB ASC 840. Prior to 840, a loophole allowed for financial statement manipulation using off-balance sheet transactions, which led to some well-known accounting scandals in 2000—think Enron.

ASC 840 applied a classification test to determine the accounting for a lease. If substantially all the benefits and risks associated with the asset were transferred to the lessee, the lease would be considered a “capital lease” and recorded as such on the balance sheet. If it did not meet one of four criteria, it was considered an “operating lease” and avoided the balance sheet altogether.

Even after ASC 840 was put in place, off-balance sheet transactions continued. But because operating leases are not included on the balance sheet,

the effects of these contracts have been excluded from financial ratios and metrics used to measure an organization’s health. Financial statement users have criticized the prior rules, and rightfully so. Operating leases are contracts in which one party has committed to paying another party for an asset for a specified period of time.

Understanding leases and distinctions

It is important to understand how a lease is defined, and certainly helps if you know the difference between what was a capital lease—now called a “financing lease”—and an operating lease. Historically, a lease was defined as an agreement conveying a right to use property, plant, or equipment, usually for a stated period of time. To be considered a capital lease, the lease had to meet one of four criteria:

1. The asset transferred ownership at the end of the term.

2. There was an option to purchase the asset at a discounted price at the end of the term.
3. The term of the lease was greater than or equal to 75 percent of the useful life of the asset.
4. The present value of the lease payments was greater than or equal to 90 percent of the assets’ fair market value.

operating lease; it would be expensed as paid each period. ASC 842 changes the definition of a lease to a contract, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration. This new definition requires, substantially, all leases to be added to the balance sheet.

Whether it’s a building, a vehicle, or another asset being leased, you can expect to see that on your balance sheet as an asset and a corresponding liability for the total lease liability, with some exceptions.

If any one of the four conditions was met, the asset was capitalized at its present market value and a corresponding lease liability recorded. Depreciation would be recorded to reduce the asset value and as payments were made, the associated liability would be relieved. If the lease was not capital, then it was classified as operating. No additional accounting was needed for the

Whether it’s a building, a vehicle, or another asset being leased, you can expect to see that on your balance sheet as an asset and a corresponding liability for the total lease liability, with some exceptions. The new lease standard freshens up the terms for what we now know as financing leases. Operating leases remain as operating leases. “Short-term” lease is another category.

Each year after initial recognition, the organization will make three entries: one entry to amortize the ROU asset on a straight-line basis over the life of the lease, one to record interest expense on the lease liability, and a third entry to record the cash payment and reduce the lease liability by the total of the lease payment (principal and interest).



photo by Eric McLean for Unsplash

The finance lease

The ASC 842 standard scrapped the specific percentages associated with tests numbered 3 and 4 above, called “bright-line” tests, and added less specific language and a fifth test. That’s not to say that the organization cannot continue to use 75 percent and 90 percent as guides, but they are not specifically stated as the measurements.

To be a finance lease, the lease must meet at least one of the following criteria:

- The lease transfers ownership of the underlying asset to the lessee by the end of the lease term.
- The lease contains a purchase option that the lessee is reasonably certain to exercise.
- The lease term is for the major part of the remaining economic life of the asset.
- The present value of the lease payments and residual value guaranteed by the lessee equals or exceeds substantially all the fair value of the underlying asset.
- The asset is specialized and expected to have no alternative use to the lessor at the end of the lease term.

As you might have noticed, the finance lease is similar to the previous capital lease.

The operating lease

Notably, ASC 842 does not change the definition of an operating lease. Instead, it indicates that a lease is operating if it’s not a finance lease. However, even though the definition has not changed, changes in how an operating lease is measured and recognized are dramatic.

Short-term leases

Short-term leases are defined as leases that are less than 12 months and do not include an option to purchase the asset. In these cases, the organization can elect not to apply the new standard. But don’t think you can avoid recognizing leases under the new standard by making them all less than 12 month. If there is an option to extend the lease beyond 12 months, it is not considered a short-term lease.

If you are a lessor, you need not read further. The new standard does not include significant changes to the lessor accounting model.

Recognition, measurement, presentation

If you currently know how to report the different leases, you will be comfortable with finance lease reporting. At the commencement of the lease, an asset and liability are recorded at the “present value” of the lease payments. The present value of the right-of-use (ROU) asset and lease liability are discounted at the rate implicit in the lease, or the incremental borrowing rate if there is no known rate implicit in the lease. The standard calls the asset an ROU asset. Don’t be intimidated by the language; it simply means the organization has a right to use the asset. Each year after initial recognition the organization will make three entries: one entry to amortize the ROU asset on a straight-line basis over the life of the lease, one to record interest expense on the lease liability by increasing interest expense and also increasing the lease liability, and a third entry to record the cash payment and reduce the lease liability by the total of the lease payment (principal and interest). The income statement shows the lease activity through interest and amortization expense.

The recognition and measurement of the operating lease are more complicated. As mentioned above, historically this would involve only cash out and lease expense. Under Topic 842, the organization must record the ROU asset and related liability exactly the same as it would under a finance lease using the present value of the lease liability. After initial recognition, the organization will increase the lease expense for the total of the lease payment (principal and interest), reduce the lease liability by the principal amount, reduce the ROU asset by the amortization amount, and record the cash payment.

Various calculations are required in the accounting. The lease expense will be recognized on a straight-line basis. The present value of the ROU asset and lease liability will be discounted at the rate implicit in the lease, or the incremental borrowing rate if there is no known rate implicit in the lease. Additionally, the amortization amount is not a consistent amount year to year, but rather, it is a balancing figure to get the operating lease expense constant over the life of the lease.

In the end, the income statement will look the same as it did under the former rules, with only the lease expense being affected. The full lease expense will be included in operating expenses.

How to prepare

There are many variables to consider in contracts that may affect the treatment and determination of the lease. Additionally, there are accounting policies to review and practical expedients available to alleviate some of your burden of execution. It is important to start analyzing your organization's leases now, as this standard is in effect in for all organizations with a fiscal year beginning after December 31, 2021.

To get prepared:

- **Determine if the organization has qualified internal resources** to take this project on. If not, consider hiring a consultant.
- **Determine the organization's lease commitments.** Start by analyzing the contracts you have in place. For example, the standard specifies that the asset must be identified in the contract; if the vendor has substitution rights, it might not be a lease.
- **Prepare a template or document for calculating the ROU asset and lease liabilities**, so you have the support to back up the balance recorded on the balance sheet and the associated amortization and interest expense or lease expense. If you have a significant number of leases, new software may be your best solution.
- **Update policies and procedures and get your team trained.**
- And, most importantly, **call your accountants.** ■

It is important to start analyzing your organization's leases now, as this standard is in effect in for all organizations with a fiscal year beginning after December 31, 2021.

HBK NONPROFIT SOLUTIONS // AUTHOR PROFILE



Darby Beaverson, CPA

HBK Principal

Darby is a Principal in the Naples, Florida office and has been with the firm since 2014. She is also the Regional Director of the Florida Assurance Practice. As Regional Director of the Assurance Practice, she is responsible for the growth and strategic direction of HBK's Assurance practice in Florida. Darby provides consulting, assurance, and business advisory services to clients in various industries. Her areas of specialization include a variety of accounting, tax, and assurance services, primarily for nonprofit and construction industries. Darby can be reached at 239-263-2111 or by email at dbeaverson@hbkcpa.com.

Outside the Lines

In each issue of Insights, we feature an HBK service line leader who will provide practical information and thought-provoking tips and ideas about their financial discipline.

Should Your Organization Accept In-Kind Cryptocurrency Donations?

By **Jesse Hubers, CPA, JD**
HBK MANAGER

Increasingly, investors are incorporating cryptocurrencies

into their portfolios. Cryptocurrency has graduated from the fringes of the dark web, where it resided for most of the last decade, to gain acceptance by mainstream institutions and investors. In February, Superbowl LVI featured three advertisements for cryptocurrency companies, one of which generated so much traffic that it crashed the company's website. Considering the widespread adoption of cryptocurrency and the tax benefits of in-kind charitable contributions of appreciated property, charitable organizations should expect to see an increased number of donors seeking to make in-kind donations of cryptocurrency.

Donors of property are entitled to a charitable deduction equal to the appreciated fair market value of such property at the time of the transfer—so long as the property has been held for more than one year.¹ At the same time, it is well established that unrealized gains are generally not recognized when a donor makes an in-kind transfer for no consideration.² The meteoric rise in the use of cryptocurrency in the last year presents an opportunity for charitably inclined taxpayers to maximize this double tax benefit. In some cases, donors



Cryptocurrency has graduated from the fringes of the dark web, where it resided for most of the last decade, to gain acceptance by mainstream institutions and investors.

photo by 惠林摄影 ©2020 for Unsplash

have almost no basis in their cryptocurrency holdings, putting the after-tax value of nonrecognition on equal footing with the charitable deduction.

While current economic conditions present a unique fundraising opportunity for charitable organizations to solicit cryptocurrency donations, the opportunity carries compliance risk requiring careful consideration and planning.

The Uniform Prudent Management of Institutional Funds Act

The Uniform Prudent Management of Institutional Funds Act (the "Act") has been enacted in 49 states, the District of Columbia, and the U.S. Virgin Islands. The only state that has not adopted the Act is Pennsylvania, which imposes substantially similar requirements through its own law. In making investment decisions for endowment funds,

the Act requires the charitable organization to (1) act in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances (the "prudence standard"),³ and (2) consider its charitable purposes and the purposes of the endowment.⁴

The Act sets forth eight factors to guide investment decisions, which require the charitable organization to consider:

- general economic conditions
- the possible effect of inflation or deflation
- the expected tax consequences, if any, of investment decisions or strategies
- the role each investment or course of action plays within the overall investment portfolio of the fund
- the expected total return from income and the appreciation of investments

- other resources of the organization
- the needs of the organization and the fund to make distributions and to preserve capital, and
- an asset's special relationship or special value, if any, to the organization's charitable purposes.⁵

The Act specifically permits charitable organizations to invest in any kind of property or type of investment consistent with its terms.⁶ There is no reason to believe that this blanket permission excludes cryptocurrency, but the prudence standard—guided by the factors listed above—will likely preclude a charitable organization from allocating sizable portions of its endowed funds to most cryptocurrencies due to their inherent volatility.⁷ Investment decisions about individual assets are not made in isolation but rather in the context of the portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the endowment and the charitable organization.⁸ Additionally, a charitable organization is required to diversify its portfolio unless special circumstances dictate otherwise.⁹ Accordingly, cryptocurrency may find a home as a small allocation within a diversified portfolio.

The big caveat to the requirements above is that they are all subject to the donor's expression of contrary intent.¹⁰ While the emphasis on donor intent does not mean that the donor can or should control the management of the charitable organization, the drafters' comments to the Act provide that a charitable organization has an overarching duty to comply with donor

intent, which is primary to the charitable purposes of the organization or endowment.¹¹ Accordingly, if the donor of a gift instructs the charitable organization to invest the gift in cryptocurrency by the gift instrument, the organization will not fall out of compliance with the Act by abiding by the donor's instructions.

As mentioned previously, charitable organizations are likely to see an increased prevalence of in-kind donations of cryptocurrency by tax-motivated donors. An organization that accepts such a donation must then decide whether to retain the

While an organization [may] generally prefer to liquidate cryptocurrency immediately upon receipt, the donor may prefer the organization to retain the cryptocurrency for a period or indefinitely.

cryptocurrency or dispose of it. The Act requires that an organization make and carry out decisions concerning the retention or disposition of property or to rebalance a portfolio to bring it into compliance with the purposes, terms, and distribution requirements of the organization as necessary to meet other circumstances and the requirements of the Act.¹²

While an organization that accepts such a donation will generally prefer to liquidate cryptocurrency immediately upon receipt to raise cash for their charitable purposes or convert it to a more suitable investment, the donor may prefer the organization to

retain the cryptocurrency for a period or indefinitely. If the donor fails to express this intent in the gift instrument, the organization will have to decide whether it will retain the cryptocurrency at the expense of its organizational goals or dispose of the property and jeopardize the likelihood of receiving gifts from the donor in the future.

Notably, the Act does not require the organization to arrive at a particular outcome – the organization may consider a variety of factors in deciding whether to retain or dispose of the cryptocurrency, and a decision to retain it for a period or indefinitely may be a prudent decision.¹³ The drafters' comments to the Act explain that the potential for developing additional contributions by retaining property contributed to the organization is among the "other circumstances" that the organization may consider in deciding whether to retain or dispose of the property. Accordingly, the organization might be able to justify the retention of a position in a cryptocurrency that is otherwise unsuitable for its investment portfolio on the grounds that the donor is a prospect for future donations. While the organization will likely be able to justify retention with documented discussion and analysis, this gray area is an uncomfortable place to be.

Federal tax reporting obligations

If the donor is claiming a tax deduction of more than \$5,000 with respect to a charitable contribution of cryptocurrency, the donee organization is generally required to sign the donor's Form 8283, if requested, to

continued on page 15

HBK NONPROFIT SOLUTIONS // AUTHOR PROFILE



Jesse Hubers, CPA, JD
HBK Manager

Jesse Hubers is a Manager with the HBK Tax Advisory Group in the Naples, Florida office of HBK CPAs & Consultants. He specializes in taxation of corporations and partnerships including formations, reorganizations, liquidations, mergers, acquisitions, and divisions. He also has expertise in like-kind exchanges including deferred exchanges and "drop-and-swap" exchange. Jesse can be reached at 239-263-2111 or by email at jhubers@hbkcpa.com.



In 1991, Sojourner House was established by Pittsburgh's Fox Chapel Presbyterian Church, community members, and representatives of 26 agencies in the Allegheny County area out of concern for mothers who were suffering from addiction but afraid to seek treatment for fear of being separated from their children.

A FAITH-BASED, FAMILY-BASED NONPROFIT, THE SOJOURNER HOUSE IS CHARGED WITH HELPING ADDICTED MOTHERS BREAK THE INTERGENERATIONAL CYCLE OF POVERTY AND CHEMICAL ABUSE WHILE REBUILDING THEIR RELATIONSHIPS WITH THEIR CHILDREN.

CLIENT SPOTLIGHT

Sojourner House: Helping Addicted Mothers Break the Cycles of Poverty and Chemical Abuse

A Q&A with De'netta Benjamin-Miller, Executive Director, Sojourner House and Timothy R. Gagen, HBK Nonprofit Solutions

Gagen. Tell us about your services and programs, and how you go about providing them?

Benjamin-Miller. We provide faith-based residential recovery services to mothers and children in the Pittsburgh area. We also offer childcare programs so the mothers can bring a child or two under 12 with them. In our long-term recovery program, they typically stay for three to six months. If eligible, the mothers can transition to our one-year short-term Sojourner House MOMS transitional housing program. Families experiencing homelessness and a behavioral health disorder can apply for our Sojourner House MOMS permanent housing program through Allegheny Link, an Allegheny County housing assistance program. The program provides housing for entire families for up to five years. We have case managers, therapists, and advisers on-site to support successful recoveries and transition children back to their mothers' care. The MOMS housing program was established in 2004 as a step-down for women coming out of treatment, to assure them of a safe place to go as they transition, but changes in the United States Department of Housing and Urban Development

(HUD) regulations now require the mothers to apply for residence through Allegheny Link.

Gagen. How has COVID affected how you deliver your services?

Benjamin-Miller. It was a day-to-day learning curve for us. As an essential business we were open 24/7. It has been a big challenge, especially trying to keep kids connected to educational services and helping parents get through home education while we provided our programs for moms under recovery. During the pandemic, we wanted to make sure families were safe and had access to educational and other activities. We weren't budgeted to spend what we needed on technology for remote work, but had to find a way to fund technology to maintain our operations, often through Zoom or Teams meetings. Surviving the pandemic speaks to our resiliency and commitment to our mission. We are interconnected. Our staff and clients are all in this together. COVID taught us that,



"We're in the business of saving lives."

De'netta Benjamin-Miller, LCSW
Sojourner House
Executive Director



Surviving the pandemic speaks to our resiliency and commitment to our mission. We are interconnected. Our staff and clients are all in this together.

and I tip my hat to all those who helped get us through it all.

During the pandemic we lost three clients to opioid overdoses, all linked to fentanyl. It only takes a little trace of fentanyl for a person to overdose and die. At the state level there is advocacy to pass a law to legalize fentanyl testing strips so overdose deaths can be prevented.

Gagen. What’s a post-pandemic world looking like for Sojourner House?

Benjamin-Miller. In a more open world, we’re looking to get back to our events. We had our Victorian tea this summer and are hosting a do-it-yourself tea in April where we, the community, and our clients can get dressed up for the occasion and take pictures to send us to help us celebrate. We will post the pictures on our website. This year we’re building a shelter in our park—it’s called MOMS Green—for children going through our summer educational program, but also to provide access to the community as a way for us to say thanks for their support. We are planning a grand opening for some time around June.

Gagen. What kinds of challenges do you face in administering your programs?

Benjamin-Miller. Sojourner House and MOMS are designed to work together. But when HUD changed its housing regulations promoting Housing First, it presented some challenges. Before we could transition our clients from our treatment program directly into our permanent housing programs, but now they have to be referred from Allegheny Link.

Mothers participating in our treatment program must call Allegheny Link for a permanent housing referral. The mothers in early recovery can contact us directly for a referral to our transitional one-year recovery program. But if they are in our treatment program, they are not considered homeless and can apply for permanent housing only at the date of their release from treatment.

When I came to Sojourner House in 2019, I was adamant about having a business plan. We’re in the business of saving lives. We finished a business plan last summer and recently completed our strategic planning sessions. We’re using the plan to drive our initiatives and establish fiscal viability for at least five years down the road. We are getting 100 percent of our board members’ donation commitments and encouraging them to be proactive in working to add more donors. With more individual donors we can be more independent fiscally and not have to depend as much on foundations. We are also increasing our fee-for-service programming, working with the Department of Human Services (DHS) program development that aligns with our mission.

Gagen. What is the value of working with accountants who specialize in working with nonprofits?

Benjamin-Miller. Our internal finance team, headed by our Director of Finance Matt Lewis has supported our initiatives, including helping us build relationships with HUD and Allegheny County.

HBK NONPROFIT SOLUTIONS // AUTHOR PROFILE



Tim Gagen, CPA
HBK Senior Manager

Tim Gagen is a Senior Manager in HBK’s Pittsburgh, PA office and has been with the firm since 2015. He has over 13 years of experience in public accounting, with a focus on manufacturing, nonprofits, service companies and other industries (distribution companies, insurance providers, claims processors). Tim also provides audit and assurance services to our clients as well as assist with CFO level services through our Client Account Advisory Services. He is part of the A&A task force for the entire firm and part of the recruiting team for the Pittsburgh office. Prior to working at HBK, Tim worked at regional firms for eight years, specializing in the post-secondary education, manufacturing and nonprofit sectors. Tim can be reached at 724-934-5300 or by email at tgagen@hbkcpa.com.



photo by John Colombo

It is important to us to have a firm that specializes in our business. HBK provides us Single Audit and tax information filing services currently. When choosing HBK seven years ago, it was important to select a firm that understood and frequently worked within the government regulations we're held accountable for in order

to continue to receive government funding. We also need to have financial best practices in place which HBK has improved over the years through their recommendations. To understand how we operate differently from a for-profit company would involve quite a learning curve for someone inexperienced in our business. ■

We're looking to get back to our events. We had our Victorian tea this summer and are hosting a do-it-yourself tea in April where we, the community, and our clients can get dressed up for the occasion and take pictures to send us to help us celebrate.

Cryptocurrency Donations (continued from page 11)

substantiate the deduction. The signature of the donee organization does not represent agreement with the appraised value of the cryptocurrency but merely acknowledges its receipt and that the organization understands its own reporting obligations if the cryptocurrency is disposed of within three years of receipt.¹⁴ If the organization disposes of the donated cryptocurrency within the three-year window, it must file Form 8282 to report information about the disposition to the IRS and provide a copy of the form to the original donor.

Remaining compliant through adequate risk management

Charitable organizations must be deliberate in their compliance efforts, establishing robust risk

management procedures setting forth detailed instructions for organizational personnel to follow whenever cryptocurrency comes through the door. Risk management procedures may be different for each organization but should include common-sense measures such as requiring any donor making an in-kind gift of cryptocurrency or establishing a fund to hold cryptocurrency to sign an approved gift instrument stating, in no uncertain terms, the donor's intent for the gift; requiring any donation of cryptocurrency with a value exceeding \$5,000 to be disposed of only with the approval of a specific individual responsible for federal tax reporting; and requiring that any purchase of cryptocurrency be accompanied by documentation of the discussion and analysis justifying the purchase. ■

1 Treas. Reg. § 1.170A-1(c)(1).
 2 The Humacid Co. v. Comm'r, 42 TC. 894, 913 (1964).
 3 UPMIFA § 3(b).
 4 UPMIFA § 3(a).
 5 UPMIFA § 3(e)(1).
 6 UPMIFA § 3(e)(3).
 7 Notwithstanding this observation, it is noted that one of the largest charities in the country, the Silicon Valley Community Foundation, is reported to hold \$4.5B in digital assets according to its financial statement, accounting for nearly a third of its total investments.
<https://www.siliconvalleycf.org/sites/default/files/documents/financial/2017-independent-auditors-report.pdf>
 8 UPMIFA § 3(e)(2).
 9 UPMIFA § 3(e)(4).
 10 UPMIFA § 3(a).
 11 See drafters' comment on UPMIFA § 3 and 3(a): "In addition, subsection (a) of Section 3 reminds the decision-maker that the intent of a donor expressed in a gift instrument will control decision making. Further, the decision-maker must consider the charitable purposes of the institution and the purposes of the institutional fund for which decisions are being made."
 12 UPMIFA § 3(e)(5).
 13 See drafters' comment on UPMIFA § 3(e)(5).
 14 IRC § 6050L(a)(1)-(2). The exception for publicly traded securities does not apply because cryptocurrency does not qualify as a "security" for this purpose. See IRS Frequently Asked Questions on Virtual Currency.



CLIENT SPOTLIGHT

**Sojourner House:
Helping Mothers**

page 12