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Nonprofit Observer

Employee checklist: Follow IRS filing rules

Retention 101
Keep your members in the fold

Don't gamble with gaming fund-raisers

IRS offers crash course online for exempt organizations

IA board is a board ... or is it?

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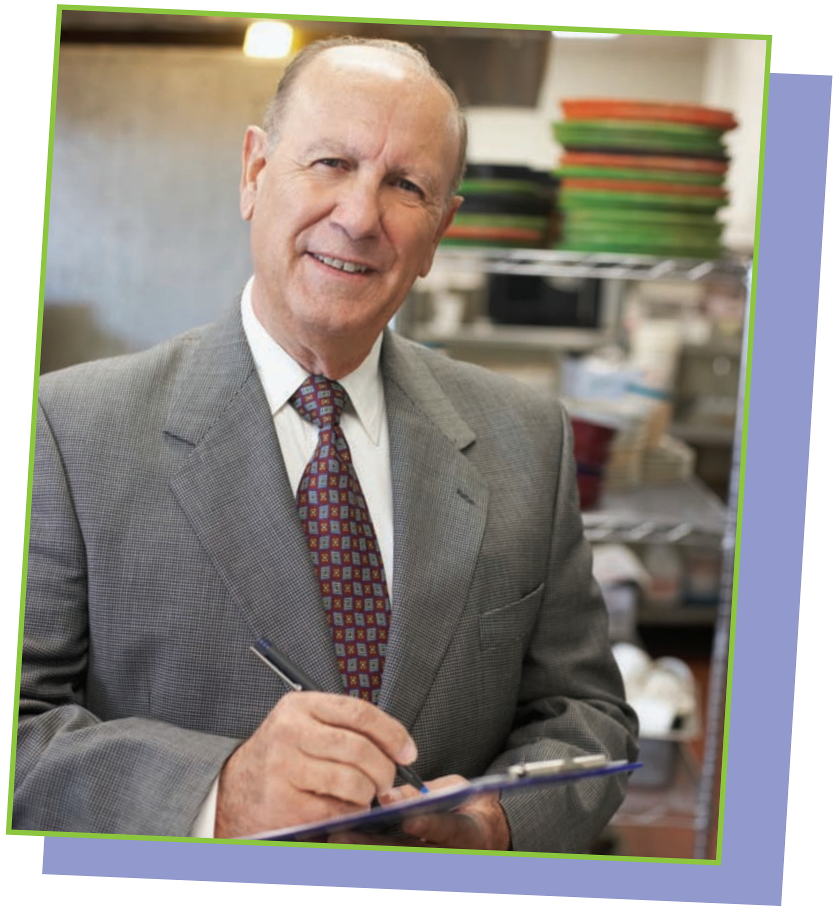
Employee checklist: Follow IRS filing rules

Does your nonprofit employ project-based staffers or hire contractors? If so, you need to stay abreast of government requirements regarding these types of workers. This includes knowing how to classify workers, secure employer identification numbers, issue W-2s and 1099s, and pay income tax withholding and Social Security and Medicare taxes.

Mistakes can be costly. If, for example, you mistakenly classify someone as an independent contractor and the IRS determines that person is really an employee, you could face a bill for taxes due from that worker, including interest and penalties. Missing a deadline can be as expensive as making a mistake: Filing late W-2s and 1099s may incur penalties.



Classify employees correctly

First, you need to know that, in the eyes of the IRS, employees and independent contractors (ICs) are different entities with different filing requirements. State and federal penalties can be stiff for misclassification.

The IRS generally separates employees from ICs based on three criteria:

1. Behavioral control refers to when, where and how a job gets done. If your organization directs the work — meaning you require the individual to work on your premises, at a set time, and perform the work according to your processes on your equipment — that person is likely an employee. If you define only the outcome of the work and the worker is free to achieve that outcome as he or she sees fit, the individual probably is an IC.

2. Financial control refers to how much an individual controls financial aspects of his or her work. For example, if a worker has ongoing expenses that aren't reimbursable (such as investments in facilities), can market his or her services to others, and is in a position to experience a profit or loss on a particular project, the person likely is an IC.

3. Relationship between parties considers how the relationship is structured. IC relationships include a contract for a particular timeframe and a specific outcome for a set fee. Employees generally handle a broader array of duties and may be paid benefits in addition to their salary.

Get your paperwork in order

Understanding the types of workers you employ can help you determine which tax forms and filings you must complete. The most basic of these are:

EIN. Even if you don't expect to have employees, you need an Employer Identification Number (EIN), which you can request by submitting IRS Form SS-4. You can obtain one on the IRS Web site at www.irs.gov.

W-2. Every year, you must issue a W-2 to each employee with totals for wages paid, wages subject to Social Security and Medicare taxes, amounts withheld for the calendar year, and other information. These must be distributed by Jan. 31 for all employees who were on the payroll in the previous calendar year. Be sure to hold onto any undeliverable W-2s — for example, for former employees who moved without indicating a forwarding address — for four years.

W-4. Because you'll need to withhold federal income tax from employees' pay, ask them to complete W-4s that attest to their marital status, number of withholding allowances, any additional tax to be withheld or exemption from withholding. W-4s remain in effect until an employee submits a change — except in the case of an employee claiming exemption. These forms must be renewed every year by Feb. 15 if changes have been made.

W-9. Obtain completed W-9s from the ICs you work with to determine if they're corporations. If they aren't, you'll need their Social Security number or EIN so you can file Form 1099 MISC. If you don't have a completed W-9, you may need to keep track of backup withholding.

Form 1099 MISC. For ICs who aren't corporations according to their W-9 and whom you pay more than $600 in a calendar year, complete a Form 1099 MISC that details how much you paid the IC. Supply a copy to the IC by Jan. 31 and file it with the IRS by Feb. 28 for the previous calendar year. You aren't responsible for withholding or paying tax or FICA for ICs.

Take care of taxes

When you have employees, you're responsible for withholding, paying and reporting employee taxes. You need to withhold federal income tax — according to the instructions in an employee's W-4 — and FICA, which includes Social Security and Medicare.

If your nonprofit is classified as a 501(c)(3), you're exempt from paying the Federal Unemployment Tax Act (FUTA) tax. You may, however, still be responsible for state unemployment taxes. All other nonprofits must pay FUTA for their employees out of their operating funds — not through employee withholding.

Employees need I-9s, too

Although it's not an IRS requirement, every employee you hire must have a completed I-9 Employment Eligibility Verification. The requirement that employers verify their employees' identities and ability to work in the United States applies to for-profit and nonprofit entities alike.

Keep all completed I-9s on file for three years from the date of hire or one year after the date employment ends — whichever is later. This requirement, which has become even more important following the events of 9/11, falls under the Department of Homeland Security's U.S. Citizenship and Immigration Services.

A good start

Enlisting the help of project-based employees or independent contractors can help you get the job done better, faster and more economically. But it's critical to play by the rules, which means ensuring all required tax forms are filed properly.

Retention 101

Keeping your members in the fold

For-profit businesses understand that it takes a lot more time and money to attract new customers than it does to keep current customers happy. The same can be said for members of your nonprofit organization. If you don't believe it, do the math. A 4,000-member organization with a 10% attrition rate and annual dues of $250 stands to lose $100,000 a year in membership fees alone. The costs creep even higher if the nonprofit sells products or services to its members.

But there's more to retention than cold, hard cash. Long-term members form your pool of candidates for leadership positions on boards and committees. And they can be influential among their peers in helping to attract new members. So, how do you keep your members in the fold? Focus on needs, value and engagement.

Needs: Give the people what they want

It may seem pretty basic, but to keep members — and attract new ones — you have to offer something that they need. Examples might include education, networking opportunities, research, discounts, certifications or credentials.

The only sure way to get a handle on what your members need is to ask them. You can accomplish this through formal surveys and focus groups, from instant feedback methods such as Web polls, and by simply asking your members every time you engage with them. How are your products and services meeting their needs? What do they need that you're not providing? Needs aren't static, so check in with members on an ongoing basis.

Value: What have you done for me lately?

Offering the right mix of products and services is a great first step to retaining members, but you can go further by emphasizing the *value proposition* of your organization. This is the unique experience that your members have when they interact with your nonprofit and its offerings.

There's more to retention than cold, hard cash. Long-term members form your pool of candidates for leadership positions on boards and committees.

Emphasizing the value of membership often means making an emotional appeal that taps into the intangibles of being part of your group. Depending on your mission, you might be able to tout the value of individuals banding together to create a powerful voice for change, the chance to help improve the conditions in your community or the ability to network with the most important thinkers in your field.

Member testimonials and case studies are a great way to communicate your organization's value. All your materials — from renewal notices to your Web site — need to emphasize the unique value you offer to members.

Engagement: Opportunities to connect

Members who are deeply engaged with your nonprofit will stay with your organization. That means you need to find ways to help members build personal connections to the organization itself, its leaders and their fellow members. Some tactics to boost engagement include:

Personalization. Treat your members as individuals whenever possible. Always address correspondence to them specifically (never to "member at large") and offer them personalized content when they log on to your Web site.

Opportunity. Create as many avenues as you can for members to participate in the nonprofit. Examples include members of committees or boards, volunteers who help manage events or contributors to your publications.

Dialogue. Strive to create dialogue. Augment one-way communication vehicles like traditional newsletters with discussion boards on your Web site. Make it easy for members to connect with each other by, for example, making your member directory available online in a password-protected area.

One last member retention idea might be the easiest to implement: Consider offering multiyear memberships. Some people will opt for the simplicity of handling their membership paperwork once every two or three years rather than on an annual basis. You increase the likelihood of people choosing this option if you offer a discount — even a small one — on multiyear memberships.

A bird in the hand

Retention of current members is as important as attracting new members. Making sure you devote adequate attention to keeping your current members in the fold will pay dividends for years to come.

Don't gamble with gaming fund-raisers

Whether you're planning to raise funds for your nonprofit with a simple bingo game or raffle, or with a more elaborate casino night, you need to understand and follow the federal rules that govern these kinds of activities. Gaming activities can open the door to unexpected taxes and trigger specific filings to the IRS.

Special circumstances

Raising certain amounts with a gaming activity that's regularly conducted may result in a required income tax filing. If your nonprofit grosses more than $1,000 in unrelated business income from regular gaming fund-raisers, it may need to file Form 990-T, "Exempt Organization Business Income Tax Return."

Your group also may be subject to the wagering excise or occupational tax. Whether these taxes apply to your situation depends on several factors, including the type of wagering you engage in, how it's structured and how your organization benefits from the proceeds.

Generally, this tax applies to lotteries or wagering pools that involve a sporting event or a contest that's conducted for profit — for example, a raffle or pull tabs where the proceeds go to an organization's general operating fund. It's best to discuss with your tax advisor the specifics of your fund-raiser to determine how these rules will affect you.

Depending on the type of game and the amount won by an individual, you may need to report the winnings to the IRS by filing a W-2G — "Certain Gambling Winnings." This applies if your fund-raiser includes a single instant/pull-tab prize of $600 or more (if more than 300 times the amount of the wager), a single bingo or slot machine prize of $1,200 or more, or a single Keno prize of $1,500. You'll need the winner's name and Social Security number to complete the W-2G.

Withholding taxes

Regular income tax withholding (at a rate of 28%) or backup withholding (at a rate of 31%) becomes necessary in certain games when prizes reach a certain threshold. Your organization is required to pay these amounts, regardless of whether you get the withholding from the winner.

No withholding is required for bingo prizes up to $1,200, but backup withholding is necessary when winnings are $1,200 or more. Pull tabs and raffles trigger regular withholding when the prize is $5,000 or more, and backup withholding is required for prizes of $600 or more in this category.

IRS rules for employees apply to those who are compensated for their work on your gaming fund-raisers, either through paid wages or patron tips. For those the IRS would deem an employee — including security guards, janitors or bartenders — you must file a W-2. For those the IRS would consider a contractor, you must file a 1099-MISC. (See "Employee checklist: Follow IRS filing rules" on page 2.) The only exception is if you hire a corporation to handle your gaming fund-raiser. These entities don't require a 1099.

Tip of the iceberg

Bear in mind that these are just some of the federal rules surrounding gaming. In addition, many states and municipalities impose their own regulations on gaming activities, including requiring licenses or permits.

Before you make a gaming activity part of your next fund-raiser, do your homework so you don't wind up gambling with your nonprofit's future. You could face everything from monetary penalties for not paying gambling withholding to the revocation of your tax-exempt status. For further details, review IRS Publication 3079, *Gaming Publication for Tax-Exempt Organizations*.

IRS offers crash course online for exempt organizations

For only 30 or 60 minutes, you could quickly improve your understanding of how to keep your nonprofit exemption or learn the essentials of unrelated business income tax (UBIT) rules — all without leaving your desk. The IRS has launched a series of online training programs on these and other topics for nonprofits.

Ample resources

"Stay Exempt: Tax Basics for 501(c)(3)s" offers stand-alone course modules on topics that include tax-exempt status, UBIT, employment issues, Form 990 and required disclosures. Each section blends factual information and real-life scenarios. Modules also include interactive quizzes to test how well you've absorbed the material.

The course on tax-exempt status, for example, is designed to help you understand that nonprofit and tax-exempt are not synonymous terms. It explains the requirements for 501(c)(3) status, the differences between a private foundation and a public charity, and the types of activities that exempt organizations need to steer clear of so they don't jeopardize their status.

You move through the "Stay Exempt" material at your own pace. Most modules can be completed in approximately 30 minutes — though the one on Form 990 is approximately one hour long.

A little knowledge

Just as many brick-and-mortar schools feature libraries, the IRS's online school has a virtual resource center. There, you'll find answers to dozens of frequently asked questions, summaries of course materials, links to applicable IRS publications and other background information.

The online courses in this series won't provide CPE or CLE continuing education credits or replace the knowledge of an experienced accounting expert. But they do offer an excellent primer about the most important elements of running your organization. To access the courses, visit www.stayexempt.org.

A board is a board … or is it?

All nonprofits have boards of directors, but not all have the same kind of board. Boards can vary widely, with different duties, responsibilities and expectations for their members. The structure, for example, can be anything from a less-involved group that takes its direction from the organization's leader, to a fully functioning, hands-on board that essentially runs the nonprofit, to boards that fit somewhere in between.

The right structure

What's the right board structure for your organization? It depends largely on what you need and where your nonprofit is in its lifecycle. The most common types of boards are:

Policy. The main duties of a policy board are oversight and governance. Policy boards are appropriate for nonprofits that are staffed by employees or volunteers. The day-to-day duties are handled by those individuals and the board provides a system of checks and balances that keep the organization on track.

Policy boards could have a range of relationships with the nonprofit's employees. The board might call the shots while senior staff focuses on delivery; review and approve strategic initiatives determined by the staff; or, in a partnership scenario, direct some issues while the staff directs others.

Working. These boards often are found in early-stage organizations or in nonprofits where there's plenty to do, but not enough manpower to do it. Members of working boards could be tasked with everything from defining a long-term funding strategy to stuffing goodie bags for a fund-raiser — possibly simultaneously. Working board members must be willing to do grunt work and switch to a more strategic mindset when necessary.

Hybrid. It's not unusual for nonprofits to start out with working boards out of sheer necessity and then transition to a policy style board as the organization takes root and gains employees and volunteers who can manage the business of running the organization. In some cases, certain hands-on tasks — such as sourcing and hiring executive staff — may remain the purview of an otherwise strictly policy board.

Remaining flexible

There are several advantages to defining the type of board you have — or want to have. First, it helps you to recruit appropriate board members because candidates will know exactly what's expected of them in terms of time and resources. Second, board and staff will work together more efficiently when everyone is clear about where their responsibilities begin and end.

Keep in mind that, as your organization grows and changes, the structure of your board may need to change with it. As they build their staff and volunteer resources, many nonprofits shift from a working to a policy board. Conversely, a policy board may need to take on a more hands-on role in times of crisis — such as during the absence of an executive director or when an aid organization is responding to a major disaster.

Common denominator

Regardless of the structure of your board, some duties are nonnegotiable. Board members must be passionate supporters of your mission and willing and able to provide the support — both financial and otherwise — that your nonprofit needs.

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We would welcome the opportunity to serve you. For more information about our services or the ideas presented in this newsletter, please contact us at (608) 836-7500 or mail@sgcpa.com.

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