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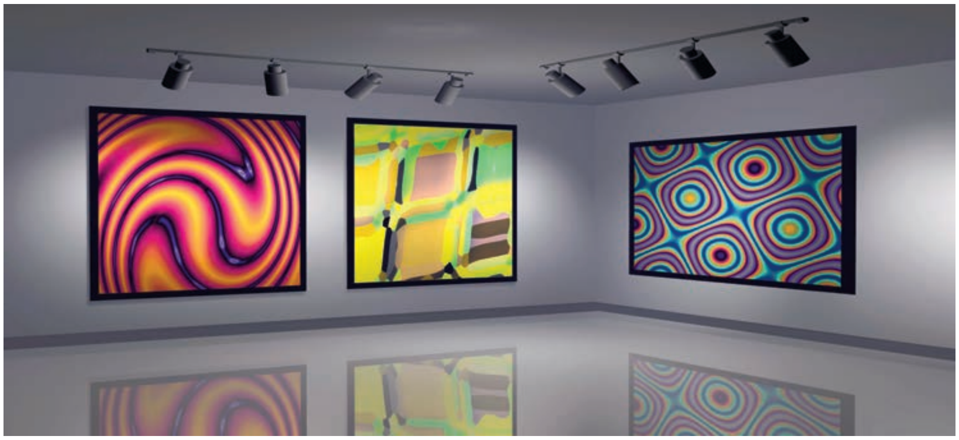

Are Museum Collections Investments?

By Mark P.S. Edward, CPA, CGMA, FCA and
Cari F. White, CPA, CVA, CFE

It's July 18, 2013, and the City of Detroit has just filed for Chapter 9 bankruptcy. The future of the Detroit Institute of Arts (DIA) hangs in limbo as the City holds legal title to certain museum assets, including artwork. If you're DIA, you say "no problem, we can sell the artwork to pay our debts"; however, the Attorney General of the State of Michigan tells you otherwise. Formal Opinion No. 7272, dated June 13, 2013, specifically states that "the art collection of the Detroit Institute of Arts is held by the City of Detroit in charitable trust for the people of Michigan, and no piece in the collection may thus be sold, conveyed, or transferred to satisfy City debts or obligations." This still-evolving issue for DIA brings up a broader question relevant to all museums – can a museum sell their collection, or a portion thereof, and use proceeds to fund operations of the organization?

Let us first summarize the current accounting treatment for museum collections. In accordance with Financial Accounting Standards Board Accounting Standards Codification 958-360, organizations can adopt one of three options for the accounting treatment of their collection artifacts: capitalize, prospectively capitalize, or expense. If a museum adopts a policy of capitalizing, purchased artifacts and artwork should be recognized on the statement of financial position at cost, and donated items would be recorded at their fair value at the date of donation. Collections that are capitalized should be depreciated; however, a major uncertainty about collection items' future economic benefit or service potential may indicate that the item should not be capitalized. Therefore, many museums adopt a policy of not capitalizing collections. While the amounts are not recorded in the statement of financial position, there are separate line items required on the statement of activities for these expensed collection items, which include (1) the costs of collection items purchased presented as a decrease in the appropriate class of net assets; (2) proceeds from sales of collection items presented as an increase in the appropriate class of net

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Our dedicated Nonprofit Services Group offers the hands-on expertise and technical skills needed to serve the distinct needs of this important sector. As trusted business advisors, we are proactive in assisting each association's management team and board of directors.

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Draft Tax Reform Act of 2014 Proposed Profound Impact on Tax-Exempt Organizations

By Laura Kalick, JD, LLM

On Feb. 26, 2014, the House Ways and Means Committee Chairman Dave Camp (R-Mich.) released draft legislation called the "Tax Reform Act of 2014" (Draft Legislation). Over the past three years Congress has held more than 30 hearings in the process of developing this proposal. Also, Chairman Camp and Ranking Member Sander Levin (D-Mich.) formed 11 separate bipartisan Tax Reform Working Groups to focus on specific issues that included tax-exempt organizations and charitable giving.

While the Draft Legislation's many provisions will be debated throughout the year ahead, and it's doubtful that it will even be voted on in 2014, it's crucial that tax-exempt organizations and charities stay on top of the process and understand the possible ramifications of the Draft Legislation's many provisions.

Some of the most significant highlights of the Draft Legislation include:

- Repealing the tax exemption for professional sports leagues
- Imposing a 2 percent Adjusted Gross Income (AGI) floor on deductible *charitable contributions*
- Imposing a 25 percent excise tax on *compensation* paid over $1million by exempt organizations to their five highest paid employees
- Expanding the reach of Intermediate Sanctions
- Tightening the rules on the unrelated trade or business income tax (UBIT)
- New and increased penalties related to return preparation
- Eliminating future tax-exempt private activity bonds

Some other provisions aimed specifically at *colleges and universities* are:

- Repealing the *rule that* provides a charitable deduction of 80 percent of the amount paid for the right to *purchase tickets for college athletic events*.
- Imposing an excise tax based on investment income of private colleges and universities. This would be similar to a rule that taxes the investment income of private foundations. Under the provision, private colleges and universities would be subject to a 1 percent excise tax on net investment income. The provision would only apply to schools with investment assets valued at the close of the preceding tax year of at least $100,000 per full-time student.
- Some of the proposed UBIT provisions appear to be aimed specifically at colleges and universities.

UBIT PROVISIONS

Both Congress and the Internal Revenue Service (IRS) have been concerned about unrelated business income, especially after the "College and University Compliance Program Final Report" indicated that underreporting of Unrelated Business Taxable Income (UBTI) resulted in an increase in UBTI for the schools totaling approximately $90 million in the aggregate and disallowance of more than $170 million in losses and net operating losses (NOLs). The Draft Legislation proposes the following:

> Unrelated business taxable income of each activity would be computed separately and the loss from one unrelated business activity could not be used to offset the income from another unrelated trade or business activity. Any unused loss would be subject to the general rules for net operating losses – i.e., such losses may be carried back two years and carried forward 20 years. The provision would generally be effective for tax years beginning after 2014. However, NOLs generated prior to 2015 could be carried forward to offset income from any unrelated trade or business, but NOLs generated after 2014 could only be carried back to offset income with respect to the unrelated trade or business from which the net operating loss arose.

Other UBIT provisions in the Draft Legislation include:

- Royalty income for the use of names and logos would be impacted. Under this provision, any sale or licensing by a tax-exempt organization of its name or logo (including any related trademark or copyright) would be treated as a per se unrelated trade or business, and royalties paid with respect to such licenses would be subject to UBIT. Many institutions that have affinity credit cards or license their name for apparel could be impacted.

- A change in the rules for Qualified Sponsorship Payments whereby mention of a sponsor's product lines would turn a mere acknowledgement that is not taxed into advertising income that would be taxed.
- A limit of the exclusion for fundamental research unless results are freely available to the general public.
- Impose a penalty on organization managers such as officers, directors or responsible employees, for the substantial under statement of unrelated business income tax.

INTERMEDIATE SANCTIONS

Under current law if a 501(c)(3) public charity or a 501(c)(4) organization pays excessive compensation (more than fair market value) to an individual who can substantially influence the organization, i.e., a Disqualified Person (DP), the DP is subject to a 25 percent excise tax. If the excess benefit is not corrected, a 200 percent tax is imposed on the individual. If the DP tax is imposed, a manager who knowingly participated in the transaction is subject to a 10 percent excise tax. A manager may avoid the excise tax if the manager relies on advice provided by an appropriate professional. An organization can establish the rebuttable presumption of reasonableness that shifts the burden to the IRS to prove that the compensation is not reasonable.

The Draft Legislation proposes some significant changes to the Intermediate Sanctions rules:

- Intermediate Sanctions would also apply to Internal Revenue Code (IRC) 501(c)(5) unions and 501(c)(6) chambers of commerce and trade associations.
- A 10 percent tax would be imposed on the tax-exempt organization when the excess-benefit excise tax is imposed on a DP.
- Managers could not rely on the professional advice safe harbor.
- The rebuttable presumption would be eliminated.
- The provision would expand the definition of disqualified persons to include athletic coaches and investment advisors.

The Joint Committee on Taxation has "scored" the provisions indicating whether the provision would raise money (and how much) or lose money, or whether it is revenue neutral. There are various provisions that impose greater penalties for not properly reporting and disclosing returns, applications for exemption or transactions; for example, changes to private foundation rules, and the reduction of the excise tax on the net investment income of private foundations to a uniform 1 percent.

CONCLUSION

It is very early in the process and we have no way to predict whether any of these provisions will become law. However it would be worthwhile for all tax-exempt organizations to take a look at the provisions to see what the impact could be.

SMALL NONPROFIT EMPLOYERS MAY BE ELIGIBLE FOR A REFUNDABLE HEALTHCARE TAX CREDIT

By Laura Kalick, JD, LLM

If you offer health insurance to your employees and there are fewer than 25 full-time equivalents (FTEs), your organization may be eligible for a tax credit. Additional criteria include average wages of not greater than $50,000. To figure average annual wages you divide total wages by the number of FTEs. The IRS Taxpayer Advocate has a page on its website that outlines the additional criteria for claiming the refundable credit, examples of the monetary benefits and a calculator so that you can estimate the benefit to your organization.

The credit is claimed by filing Form 990-T even if the organization does not usually file this form.

The credit was enacted into law in 2010. If an organization was eligible and missed the opportunity to claim the credit, an amended return can be filed to make the claim for a tax year that is open.

In general, the credit (that cannot be greater than payroll taxes paid) is equal to 25 percent of healthcare premiums paid. For tax years 2014 and beyond the credit is increased to 35 percent.

For more information and calculations as to how this can benefit your organization, click on this link:

http://www.taxpayeradvocate.irs.gov/calculator/SBHCTC.htm

We hope you find this information useful. If you know of others who should regularly receive this newsletter, or you would like to be removed from this mailing list, please email jmihoces@hertzbach.com.

Museum Collections *(continued from cover)*

assets; and (3) proceeds from insurance recoveries of lost or destroyed collection items presented as an increase in the appropriate class of net assets.

What might happen if the purpose of the collection items changes? No longer are collection items assumed to be held for use; where any sales of collections and the related proceeds would be required to be reinvested in new collection items or endowment funds. If a museum decides it wants to sell its collection and use the proceeds to fund operating expenses or meet debts, what accounting challenges arise? How is the fair value of the item determined to calculate the gain or loss from sale? Who determines that fair value? Do these collections now need to be classified in the statement of financial position as an investment portfolio? Would selling pieces of a collection and using them to fund operations trigger potential unrelated business income? If the fair value of an item decreases, should an impairment loss be recognized in the financial statements?

Then, when all of the accountants have satisfied generally accepted accounting principles and legal requirements, will the general public ever understand why their favorite masterpiece was sold to pay the utility bill or fund the employee pension plan?

FASB Outlook - How Recent Decisions by the FASB Board to Reset Its Agenda Might Impact Nonprofits

By Laurie Arenda De Armond, CPA

The Financial Accounting Standards Board (FASB) voted Wednesday, Jan. 29, to reorganize its future agenda in order to focus more closely on the issues most important to FASB stakeholders. This comes as the board anticipates completion of its remaining four convergence projects for harmonizing U.S. GAAP with International Financial Reporting Standards (IFRS).

The reorganization of the FASB agenda was guided by the results of a survey conducted by the FASB last year of more than 100 members of various FASB advisory groups and other interested parties on future priorities for standard-setting. The group surveyed consisted of a number of different stakeholders that included preparers, investors, auditors, academics, industry organizations, and other users and readers of financial statements.

How might the reorganization impact non-profit organizations? There are several key areas to monitor over the coming months, including:

THE GOVERNMENT ASSISTANCE PROJECT

The FASB board voted to add this project to its technical agenda as a way to develop guidance for disclosure requirements related to various types of government assistance. Presently, the FASB's Accounting Standards Codification lacks specific guidance on accounting for and disclosure of government assistance, which some believe results in significant shortcomings in these organizations' financial statements. There currently exists guidance promulgated by the International Accounting Standards Board under IFRS 20, Accounting for Government Grants and Disclosure of Government Assistance, and since convergence with IFRS is a fundamental goal of the FASB, we can expect the board to investigate how those standards would impact any guidance issued in this regard.

PROJECT REMOVAL

The FASB board also voted to remove the Not-for-Profit Financial Reporting: Other Financial Communications project from its research agenda. In this project, the FASB was considering whether adding a Management Discussion and Analysis section to nonprofit financials would be useful. While the board discussed a number of factors underlying the basis of its decision to remove this project, the key factors revolved around whether the final recommendations would be voluntary rather than mandatory. There was also a general cautiousness around tackling a project beyond the scope of traditional standard-setting activities, as it involves reporting outside of the basic financial statements.

PRIVATE COMPANY COUNCIL

During the meeting, the board also decided that the Private Company Council (a group of stakeholders that works with the FASB to determine adjustments in accounting standards for privately held companies) should consider doing pre-agenda work on phase two of the Definition of a Nonpublic Entity project. This may impact nonprofits that are required to include certain financial statement disclosures that are normally reserved for public companies by virtue of the fact that they hold public debt instruments, which make them, by definition, "public" entities.

As the FASB's agenda reorganization begins to take effect over the coming months, stay tuned to the Nonprofit Standard for the most up-to-date insights and analysis.